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Corrections & Clarifications

B "The Happy Space in the Medicare Debate" (Politics & Policy, June 6-June 12, 2011) incorrectly implied that a quote from Boston University professor Austin Frakt came from the magazine's interview with him. It was a title he placed on a blog post.

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Opening Remarks



Understanding the Word 'No'

Ace qualifications and national need don't matter in the nominations game. It's all politics—and maybe that's not so bad. By Stephen L. Carter

A few years ago a friend asked me over lunch whether I knew of any "dirt"—his word—on a person who had recently been nominated to a post requiring Senate confirmation. The "groups," he said, had decided to oppose the appointment and were trolling for information. In other words, a smear campaign was coming.

This tale comes to mind in the wake of economist Peter Diamond's dramatic and angry withdrawal on June 6 of his candidacy for a post on the Federal Reserve's Board of Governors. Diamond (above), who last year was awarded the Nobel Prize in Economic Sciences, was opposed by Republicans led by Senator Richard Shelby of Alabama. While Shelby claimed this was because Diamond had too little experience in monetary policy and he couldn't back "decisions made by board members who are learning on the job," the real aim was to turn Diamond's confirmation process into a referendum on President Barack Obama's economic policies.

Then there's the looming battle over the nomination of John Bryson to serve as Commerce Secretary. In this case, it's not Bryson's expertise that's under fire—he ran California's largest utility and is on the boards of Boeing and Walt Disney—but his role as a co-founder of the Natural Resources Defense Council. This has stirred opposition, even among some Democrats. Senate Republicans have promised not to allow a vote on the nomination until Obama submits for congressional approval the pending free-trade agreements with Colombia, Panama, and South Korea.

None of this is particularly fair to Diamond or Bryson. Still, the clamor of outrage among their supporters is, to say the least, ahistoric. What's happening today is no different from what has happened to nominees over the past half century or so, when politicians and interest groups discovered that confirmation fights are excellent opportunities to fight for political advantage.

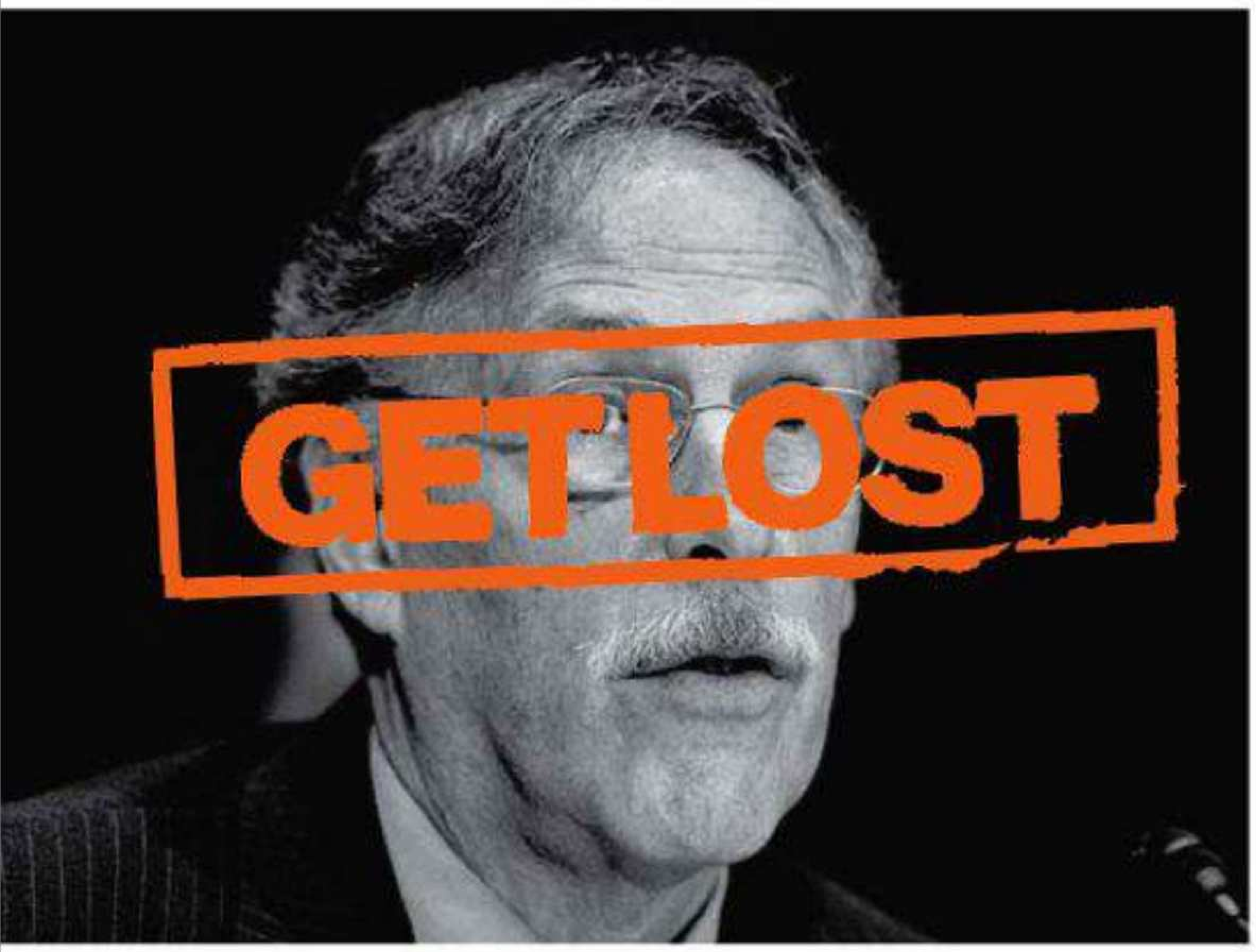
We are so accustomed to vicious and distorted attacks on nominees for judicial office that we easily forget that others, too, can find themselves caught up in nasty tussles. One need only recall the treatment of Lani Guinier, President Bill Clinton's initial nominee to head the Justice Dept.'s Civil Rights Div., whose opponents distorted her scholarship beyond recognition. Or Robert Gates, the outgoing Defense Secretary. He was nominated by President Ronald Reagan to run the CIA in 1987, but the nomination was withdrawn when Democrats protested his alleged involvement in the Iran-Contra scandal. (The accusation was that Gates had known more about the affair than he told investigators; the independent counsel wound up not pursuing the matter, and Gates finally got the CIA job in the George H.W. Bush Administration.) Speaking of the CIA, one might also recall Theodore Sorensen, who was nominated in 1977 to head the agency but had his nomination withdrawn following accusations that he was a pacifist.

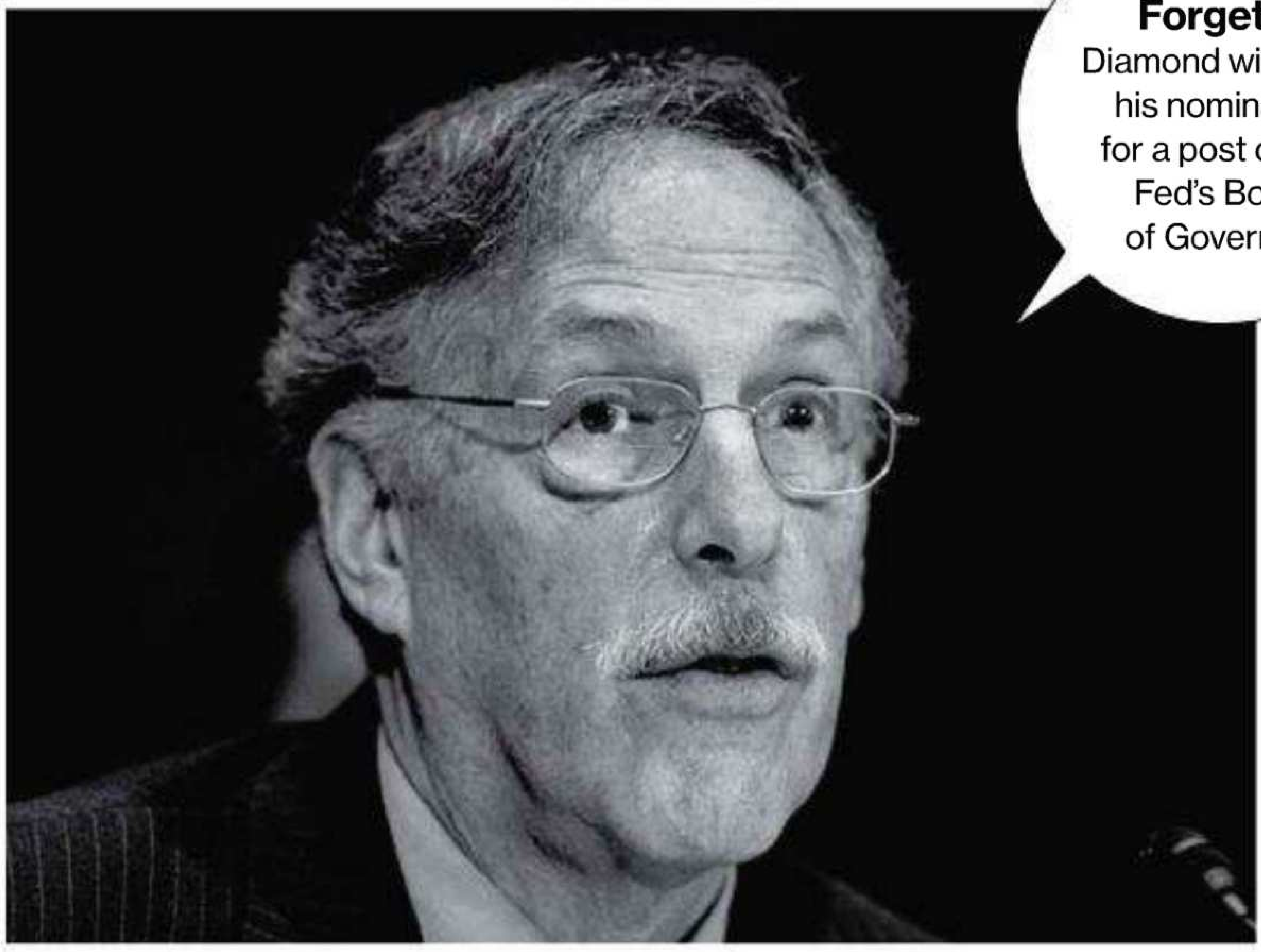
Although only a handful of executive branch nominations are actually defeated, the number generating controversy has risen steadily. Democrats think only Republicans get obstreperous, and Republicans think the same about Democrats. The truth is, everybody does—and with increasing frequency; Diamond was the 20th nomination to Obama's executive branch to have been withdrawn.

Political scientists suggest that senators use high-profile nomination battles as opportunities to communicate their own views to their constituents and to the interest groups so necessary to their election. Now that the Internet has made organizing easier and coupled elected

ANDREW HARRER/BLOOMBERG

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Forget It!
Diamond withdrew his nomination for a post on the Fed's Board of Governors

officials more tightly to the interest groups that monitor their every word, the number of nominations that generate controversy is bound to increase.

One reason the attacks on nominees are so strident is to overcome the presumption that the President is entitled to "his own team." But the presumption is a myth. The Founders envisioned a heavy Senate role in appointments. Alexander Hamilton suggested in the *Federalist Papers* that the requirement of confirmation would, among other things, keep the President from filling the executive branch with those who were "in some way or other personally allied to him." Indeed, a reason there were scarcely any squabbles over Cabinet members for the first 90 years of the republic is that Presidents consulted closely with leading senators in deciding whom to appoint.

The tradition began to decline as governing grew more complex and was thrown over entirely during the Presidency of Rutherford B. Hayes. Part of the problem was that executive appointments had become part of the spoils system for powerful senators. But, as we do so often, we tossed out the baby with the bath water. Determined to end the corruption, Hayes forced his appointments down the Senate's collective throat. Thus Hayes, known to history for the infamous bargain that bought the Presidency at the cost of ending Reconstruction, also largely subdued the Senate as a serious partner in the appointments process.

Since that time, Presidents have worked hard to keep their executive appointments away from serious Senate scrutiny. One way to do this is to make recess appointments, intended by the Founders to tide the nation over when the Senate happens not to be in session. Nowadays, Presidents use this dodge to get people into slots the Senate might not let them have. President Obama has made nearly 30 recess appointments in his first two years in office, not an unusually high number these days–unless your baseline is the way the constitutional system of checks and balances is supposed to work. Given the ever-greater likelihood that executive branch and agency nominees will run into trouble, it's easy to see why Presidents yield to the temptation to thwart the constitutional system of checks and balances: They know Congress will never punish them for it.

The confirmation process may not be fixable. In the nation's first days, the Senate had to approve fewer than a dozen of the President's aides. Today, more than 500 executive branch posts require Senate confirmation. With politicians, interest groups, journalists, and bloggers engaged in the constant quest for advantage, a few nominees will always become objects of controversy. There are too many contested issues, too many flash points, and–most important–too many constituencies demanding constant signals that their particular concerns are uppermost in the minds of their elected officials.

The process may not be fixable. There are too many contested issues and too many constituencies

Congress is considering a significant reduction in the number of positions requiring confirmation–an increased centralization of power in the executive that would have appalled the Founders and should appall us, too. A possibility rarely mentioned is to shrink by a significant amount the size and scope of the federal government. A smaller executive branch would mean less need for Senate confirmation. Indeed, the steady rise of confirmation fights in the years after World War II predictably tracks the steady rise of federal agencies. Yet significant shrinkage seems politically unlikely–every agency lives symbiotically with several well-organized interest groups.

Yes, it would be lovely if grasping interest groups would stop digging for dirt and hungry politicians would stop grandstanding, but democracy is rarely lovely. Democracy is clamorous and disputatious. The more distant people feel from those who govern them, the louder their clamor to be heard. The clamor does not necessarily lead to right answers or wise decisions. But democracy is a process, not a result.

Those loud voices–those out-of-context sound bites, those sudden savagings of the reputations of the innocently qualified–have always been part of our democracy. It's ugly and painful and often unfair. It's also the American way; and with a federal government so vast, interest groups so diverse, and the battle for press coverage so intense, it is likely to get worse.

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Bloomberg VIEW

Merkel's Role in Europe's Currency Crisis ● Kevorkian's Legacy

Merkel's Choice: Win the Nation Or Save the Region

Life is good for Germans these days. Exports are booming, thanks to the crisis-weakened euro and concessions German workers have made in recent years. Unemployment is falling, the economy is growing, and business confidence is near a 20-year high. Such strong performance tends to dull any sense of urgency, which might explain why Chancellor Angela Merkel, leader of the euro area's largest and wealthiest member state, has done little to stem the European debt crisis raging around her.

With Merkel's Christian Democratic Union party struggling to regain momentum ahead of federal elections in 2013, asking Germans to bail out the euro area's more profligate members is politically fraught. Yet a debt restructuring that involves big losses for German banks—with $22.7 billion in loans outstanding, they are the Greek government's single biggest lender—might trigger another financial crisis. Expediency would suggest Merkel find a middle way. She could, for example, endorse a version of the Vienna Initiative, in which private creditors agree to purchase more Greek bonds when existing ones mature. Used in Eastern Europe in 2009, the approach has drawn the support of European Central Bank President Jean-Claude Trichet and the European Union's economic and monetary affairs commissioner, Olli Rehn.

The proposal would give Greece more time to get its debt burden on a sustainable trajectory and banks more time to prepare for a restructuring that may prove inevitable. To give it teeth, Merkel could propose that the ECB automatically stop accepting as collateral the bonds of Greece, Portugal, or any other member state that failed to meet specific fiscal targets within three years.

Such a deal, however, is unlikely to calm markets. Investors would still worry about the impact on banks if Greece failed to fulfill its promises. More importantly, Merkel would be wasting an opportunity to fix the flaws in the euro area that the crisis exposed.

Without some sort of fiscal union in which tax revenue can flow across borders, the common currency puts too much of a burden on economies that fall out of sync. The massive public and private debts of Greece and Portugal arose in part as a result of large trade deficits—deficits that exchange-rate adjustments could have alleviated if the two countries had their own currencies. Now they must undertake the difficult task of restoring competitiveness by lowering wages, even as they cut government spending and struggle with stagnating or shrinking economies.

In what could be viewed as the world's largest currency union, the U.S., automatic federal transfers such as unemployment insurance and tax credits for low-wage earners help the states get through hard times. A supra-national finance ministry could make similar fiscal transfers in Europe, helping to ease the cyclical pain as countries undertake structural reforms.

Fiscal transfers in Europe might not need to be all that large. In the U.S., money from Washington generally covers about 30 percent of states' income shortfalls. Using that rule of thumb, a similar fiscal cushion for Greece would cost about €7.5 billion, or about $11 billion, in 2011. That's 0.3 percent of Germany's projected economic output and less than 0.1 percent of the entire euro zone's.

Tellingly, Trichet, one of the few officials involved who doesn't have to worry about reelection, suggested on June 2 that the euro area consider creating a unified finance ministry, a precursor to a fiscal union. Without a fiscal union, the euro area will see more crises and could ultimately fail as a currency union. That would be a loss for all its members, Germany included. As President Barack Obama jawbones Merkel to be more assertive on the debt crisis, he might want to pose a question: How do you want to be remembered, as the politician who saved your party's chances in the 2013 elections or as the one who saved the euro?

The Death of an Important Crank

Cranks move the world; polite, modest, unassuming people with measured views usually don't. Dr. Jack Kevorkian, who died on June 3 at age 83, was a crank and a publicity hog. He also was a hero.

Kevorkian's cause was assisted suicide—the right of people with painful terminal illnesses to end their suffering in the only way possible. Naturally, as a crank, Kevorkian took this too far. When, on their fifth attempt, authorities finally convicted Kevorkian of second-degree murder, it was because he had videotaped himself administering a lethal injection, bypassing the gruesome devices he had invented to enable patients to inject themselves. Then he sent the videotape to *60 Minutes*. He spent eight years in prison, winning release only after promising that he wouldn't help people kill themselves.

In a Gallup poll released in May, Americans were split down the middle on doctor-assisted suicide: Forty-five percent said they found it morally acceptable, and 48 percent said the opposite. It was the most divisive social issue in a survey that included questions on gay marriage and cloning.

We don't dismiss the dangers of legalizing assisted suicide, especially the threat of undue pressure on old or sick people or—at worst—the emergence of a new social norm that would make assisted suicide a routine or even prescribed method of dying. Everything possible should be done to make assisted suicide a bad option. In a free country, though, it should be an option. The issue requires no consensus: People should decide for themselves. B

▶ *To read Virginia Postrel on light bulbs and liberty, and Simon Johnson on Jamie Dimon, go to: Bloomberg.com/view*


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All price statistics taken from page 13 of the April 2011 edition of the US Department of Energy's "Clean Cities: Alternative Fuel Price Report."

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Global Economics



CHRIS RATCLIFFE/BLOOMBERG

As Cameron Wields the Ax, Britain Cringes

▶ The Prime Minister's $130 billion spending-cut plan is in full swing, and Britons are uneasy

▶ "It started to dawn on us that things were going to change"

On June 5, the British paper the *Observer* ran a letter from 52 economists begging Prime Minister David Cameron and Chancellor of the Exchequer George Osborne to rethink their radical plan to lower government spending. "Recent economic figures have shown that the government urgently needs to adopt a Plan B for the economy," said the letter. Then came a rare bit of good news for the Prime Minister: an International Monetary Fund report urging Cameron and Osborne to stick to their guns. "Strong fiscal consolidation," wrote the IMF, "remains essential to achieve a more sustainable budgetary position."

The arguments over Cameron's plan are getting heated as the Conservative-Liberal Democrat government presses on with the grim task of executing the deepest budget cuts since World War II. The government envisions about £80 billion ($130 billion) of spending cuts plus £30 billion of tax increases over the next four years. Last year, when the cuts began, was the easiest to bear: Some £6 billion in efficiencies were realized by the government in its various departments. Few layoffs occurred.

This year the pain has intensified. Britons have already felt the pinch of a sales tax boost to 20 percent, from 17.5 percent, which the Office for National Statistics says has added three-quarters of a point to the inflation rate, now at 4.5 percent. A two-year pay freeze for public-sector employees started in April, and cuts on welfare spending, including a three-year freeze in child benefit payments, are under way. A total of 310,000 government-funded jobs are to be wiped out by 2015; about 20,000 of those will be gone by the end of this year.

The psychological effect of the Cameron plan is significant. As the budget cuts unfolded, Sally Wheatman figured her days as a communications officer for the local government in Manchester, 163 miles north of the capital, were numbered. She volunteered to be laid off in April and started a public-relations company with her payout. Though she says she's optimistic about her prospects, Wheatman thinks "very carefully" before making big purchases, and all around her she sees people reflecting "long

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Global Economics

Not the best of times for Mr. Roboto page 25 ▶



If British consumers keep a death grip on their wallets, they'll kill any chance of a strong recovery

and hard" about their spending. "I don't get the sense that there's a light at the end of the tunnel," says Wheatman, 45. "When we saw how severe the cuts were, it started to dawn on us that things were going to change."

There are already 2.5 million Britons out of work. As of March, the unemployment rate had held above 7.6 percent for 22 months. The possibility of a worsening job market weighs on consumers, who have seen their incomes squeezed by rising prices for everything from food to car insurance. **VocaLink**, which processes 90 percent of British salaries paid directly to bank accounts, says annual wage growth in the three months through May was 1.8 percent, not even half the inflation rate. "Income isn't keeping pace with inflation, which is making people nervous," says Nick Moon, a managing director at **GfK NOP**, a research company that conducts national surveys on consumer confidence. "People aren't going to be rushing out to spend."

If consumers keep a death grip on their wallets, they could kill any chance of a strong recovery and deprive the Treasury of the tax receipts it needs to get the deficit under control. As it is, the economy stagnated over the last two quarters. The IMF lowered its 2011 growth forecast for Britain to 1.5 percent, from a 1.7 percent projection in April. While the weak pound should help manufacturing exports, it will do nothing to encourage consumers to start spending.

Adding to the uncertainty is concern about the next move by the Bank of England, Britain's central bank. "Consumer-spending growth is going to be sluggish at best," says John Bason, finance director of London-based **Associated British Foods**, which owns the **Primark** chain of discount clothing stores. "If the authorities were to start tightening interest rates, that has to be negative for the U.K. consumer."

So far the BOE has left the key interest rate at a record-low 0.5 percent. "They're frightened that weak demand growth isn't just a soft patch but something more sustained," says Richard Barwell, an economist at **Royal Bank of Scotland Group** in London and a former BOE official. "It's become a really big deal." Yet the central bank also has to check rising inflation caused by high commodity prices, the increased sales tax, and a weak pound, which makes imports more expensive. Andrew Sentance, who just stepped down from the BOE's Monetary Policy Committee, has been campaigning to increase the benchmark rate to control inflation. Martin Weale, another committee member, and Spencer Dale, the bank's chief economist, both sided with Sentance this year.

Cameron and Osborne have said they're counting on the BOE to keep policy loose as they push government spending down to 40 percent of gross domestic product from 47 percent. Their plan calls for six consecutive years of spending cuts, a feat that eluded even former Tory Prime Minister Margaret Thatcher. The government's Office for Budget Responsibility forecasts that the deficit, which reached a record 11 percent of GDP in the aftermath of the recession, will narrow to 7.9 percent of GDP by March 2012. So far, though, the efforts of Cameron and Osborne have not gained traction. Britain posted a £10 billion budget deficit in April, the largest for the month since at least 1993, as tax income fell and government spending rose.

That's keeping pressure on Osborne, who only has to look 1,500 miles east to see how Greece is being punished by the bond market because of the perception that it's wavering in its budget commitments. The British government could find itself in similar circumstances if it starts to backpedal. "It's very possible that U.K. growth will disappoint and tax revenue may be less than forecast and they may miss their fiscal targets," says David Tinsley, an economist at **National Australia Bank** in London and a former central bank official. "The market will take a harsher view on signs they aren't committed to meeting the cuts."

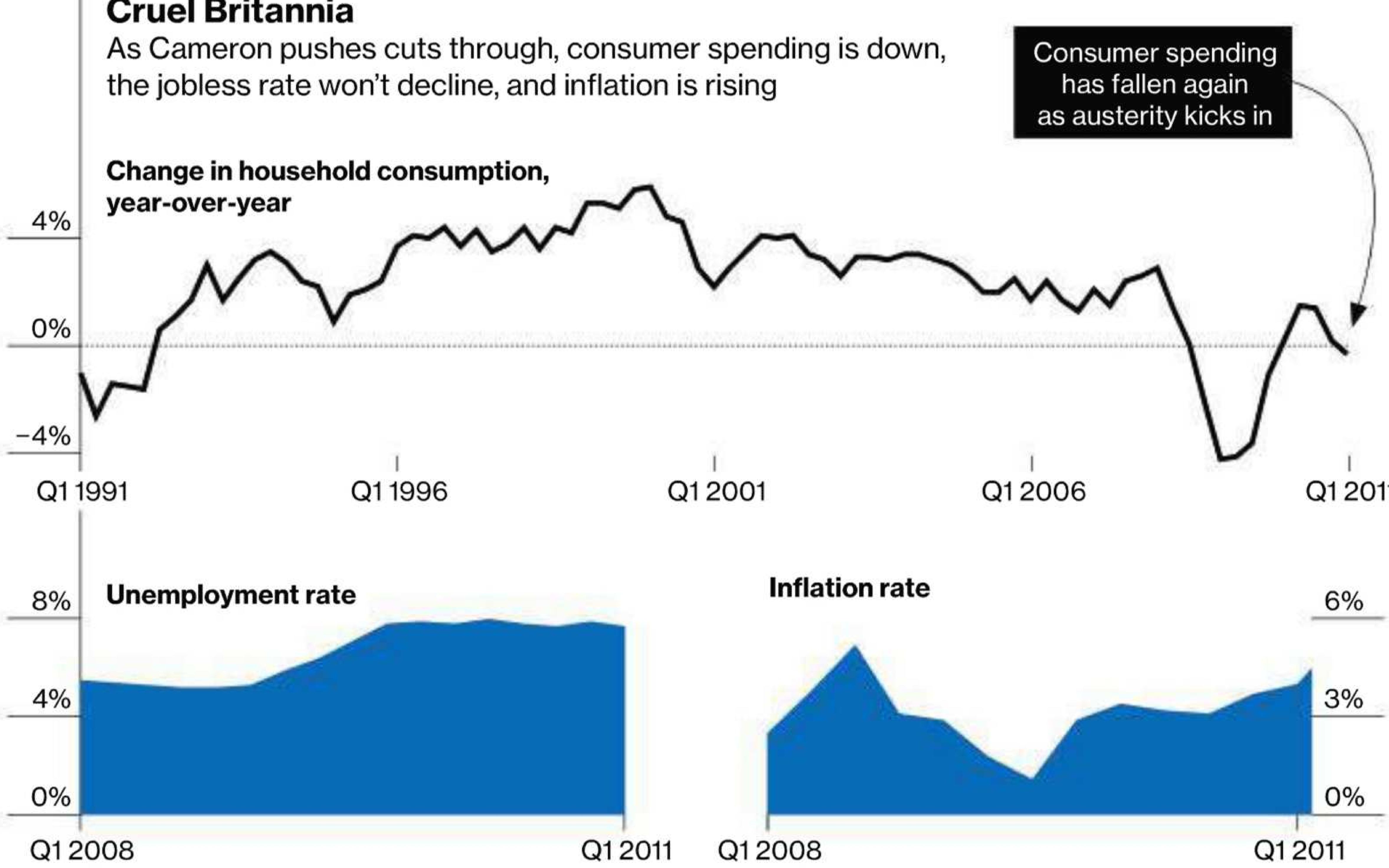
A wild card is organized labor's reaction to austerity. So far the unions have made plenty of noise about staging a showdown with Cameron. Little has come of it. Now the Public & Commercial Services Union, the largest civil service trade union, which represents about 300,000 workers, is balloting its members on a possible strike to protest the job cuts. At a conference of the GMB, another major public-sector union, in Brighton on June 6, Vince Cable, Cameron's business minister, was heckled when he raised the possibility of government action to curtail strikes.

"Confidence is quite easy to lose but hard to get back," GfK's Moon says. For now, "people see themselves getting poorer." — *Jennifer Ryan*

The bottom line *While Cameron pushes ahead with deep budget cuts, consumers are refusing to spend and inflation is headed toward 5 percent.*

Cruel Britannia

As Cameron pushes cuts through, consumer spending is down, the jobless rate won't decline, and inflation is rising



DATA: ONS

FROM LEFT: DAVID BERGMAN/CORBIS; AP PHOTO

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Kalmadi, ex-chief of Delhi's Commonwealth Games, can't have his orthopedic mattress

Corruption

India's Powerful Can't Escape Jail

▶ A scandal over a telecom spectrum sale snares members of the elite

▶ "These people for once are being treated like a normal slum dweller"

Billionaire Shahid Balwa, the former managing director of Mumbai-based **DB Realty**, is accused of manipulating a government sale of mobile-phone spectrum. In custody since Feb. 9, Balwa has been held at Delhi's Tihar Jail, home to mass murderers and terrorists, even though he and his company maintain his innocence and he hasn't been formally charged. According to the prison spokesman, Balwa sleeps on the floor in a 10-by-15-foot cell and is roused every morning at 6:30 for roll call. The jail and the courts recently refused his request for an iPad.

The jail also holds ex-Telecom Minister Andimuthu Raja, accused by India's Comptroller and Auditor General of incurring a nearly $31 billion loss to the treasury by selling spectrum at a "ridiculously low price" to Balwa; Sanjay Chandra, the son of a billionaire and managing director of developer and mobile-phone operator **Unitech**; and three high-ranking executives at billionaire Anil D. Ambani's **Reliance ADA Group.** All are ensnared in the same telecom probe. Reliance says its executives are not guilty and deserve the presumption of innocence. Raja and Chandra deny any involvement in a fraud.

For Indians, the travails of Balwa and the others provide both comic and karmic relief. Newspapers including the *Times of India* carry regular updates on how the mighty have fallen, describing for example the 400 grams of wheat, 250 grams of vegetables, and 90 grams of cereal a day the jail allows each prisoner. "The general public is happy that these people for once are being treated like a normal slum dweller would," says Sunil Gupta, legal adviser and spokesperson for Tihar.

Other scandals are represented at Tihar. Suresh Kalmadi, the former chief of Delhi's Commonwealth Games, is charged with misappropriating funds. He says he is innocent. Kalmadi's unsuccessful request for an orthopedic mattress made headlines in India. To profit from the incarcerations, local website ibibo.com has developed a game where players can parade online avatars of Raja, Kalmadi, and others on donkeys, beat them with shoes, and place them behind bars.

The phone probe is largely driven by a class action filed by an anticorruption activist. The Supreme Court got directly involved, directing the Central Bureau of Investigation to arrest the suspects even if they are "on the *Forbes* list of millionaires," according to court documents.

Prime Minister Manmohan Singh has been fighting off allegations that he has allowed corruption to fester. He resisted the creation of an independent anti-corruption body, agreeing to hold discussions on the proposal only after a social worker, Anna Hazare, went on a hunger strike, as did a popular yoga guru, Swami Ramdev, on June 5. Although the guru was moved by the authorities to a Himalayan village, the uproar has not died down. —*Mehul Srivastava*

The bottom line *High-profile arrests in several corruption cases have overjoyed Indians. The conviction rate in such cases remains low.*

Elections

Peru's New Leader Unnerves Investors

▶ President-elect Humala has to show he's more Lula than Chávez

▶ "Humala may be a moderate but the people surrounding him aren't"

Ollanta Humala, an ex-paratrooper with a radical past, convinced a bare majority of voters that Peru's economy would be safe with him as President. Now he must calm investors. Peru's stock market slid 12 percent on June 6, after Humala edged out the investor-friendly Keiko Fujimori in the June 5 runoff.

Investors are concerned Humala could reverse policies that have attracted $50 billion in investment and fueled average annual growth of

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12%
The one-day slide of Peru's stock market after Humala's runoff victory



5.7 percent in the past decade. "Humala has to send a signal," says Mauricio Cardenas, director of the Latin America program at the Brookings Institution. "The market is asking for a response. It wants to hear who the finance minister will be."

Omar Chehade, who will serve as one of Humala's two Vice-Presidents, says the future finance minister may be an ally of ex-President Alejandro Toledo, who embraced a pro-market philosophy during his 2001-06 presidency. Kurt Burneo, Toledo's Deputy Finance Minister, and Oscar Dancourt, the central bank president during the Toledo years, are both under consideration. Humala may also keep the current, well-regarded head of the central bank in his job.

Ahead of the runoff, Humala softened a platform that included a proposal to ban gas exports to lower domestic fuel costs. He also downplayed his enthusiasm for the socialist credo of Venezuela's Hugo Chávez, which dogged him during his failed run for President in 2006: Voters in that election also remembered how Humala and some troops seized a foreign-owned copper mine and occupied it for a week in 2000. For his latest campaign, Humala hired two ex-advisers of Luiz Inácio Lula da Silva, who won Brazil's 2002 presidential race by persuading voters that his union past wouldn't result in hard-left policies.

As part of a tour before he takes office, Humala will go to Brazil to see Lula's successor and protégée, Dilma Rousseff, before taking office on July 28. Brazil's economy expanded 7.5 percent last year, while Venezuela's was the last in Latin America to emerge from the global recession. Chávez's nationalization of key industries has led to food shortages that are driving annual inflation in the double digits. "Humala's had enough time to see that Venezuela's economy is a disaster," says Cardenas.

Local investors are more worried than their foreign counterparts that Humala's changes are cosmetic. "Humala may be a moderate, but the people surrounding him aren't," says Pablo Secada, chief economist at the Peruvian Institute of Economics, a research organization. One obstacle to radical change may be Peru's Congress, where Humala's Nationalist Party, founded only six years ago, has just 47 of 130 seats. "Compared with Lula and his people, Humala is a political amateur," says Steven Levitsky, a professor of government at Harvard University. *—Helen Murphy and John Quigley*

The bottom line *Peru's new President, Ollanta Humala, needs to reassure investors that he is now a centrist. His choice of finance minister is essential.*

Agriculture

Weather Mayhem May Yield High Food Prices

▶ Post-flood plantings of rice, corn, wheat, and beans are weeks late

▶ "We just can't afford to have weather issues"

When the overflowing Mississippi breached Arkansas's levees and flooded Michael Oxner's farm in May, the waters didn't just wipe out his hopes of planting 1,400 acres of rice. It destroyed last year's crop, too. Water inundated the bins that held the rice he'd harvested in 2010, ruining 25,000 bushels and leaving a fermented smell that turned his remaining stores into pet food.

Oxner lost $375,000 in 2010 rice alone. His rice land, along with 300 acres planted with corn, won't be usable this season. Since it's too late to plant more corn, the 2,000 acres he has left will go into soybeans, which grow faster than other crops but fetch less on the market. Even with soybeans, Oxner is cutting it close: Soybeans usually go into the fields in May. This year's planting started on June 4. "I won't know how bad it will be until fall," he says.

Oxner's ordeal is being repeat-

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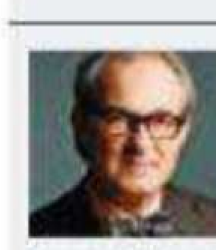
Tom Keene's EconoChat

Tom talks with **Stephen Roach**, Morgan Stanley's non-executive chairman for Asia, on the U.S., China, and Japan

How do our economic policies resemble Japan's failed policies?
I think the No. 1 thing was to look the other way when these monster bubbles built up. And we failed to use regulatory and monetary policy to prevent the contamination of our real economy by bubbles. We're still in denial over the linkage between bubbles and economic activity. Unless we crack that denial, we could be in a Japanese-like shakeout ourselves.

What is the most important reason that China is different from Japan?
The one that is most intriguing to me is the shift away from manufacturing into services. Services generate about 35 percent more jobs per unit of Chinese GDP than do manufacturing and construction. That means as they move from manufacturing to services, they can slow growth down to a 6 or 7 percent rate and still create as many jobs as they do with the current model, which requires 10 percent growth. China has a strategy to change its model, Japan did not.

Don't the Chinese view any economic slowdown with fear?
Their key goal, Tom, is absorbing surplus labor and maintaining social stability. If they can do that with slower growth, they would be delighted. The Premier of China, Wen Jiabao, has stated repeatedly that while the Chinese economy is strong on the surface, beneath the surface it is unstable and ultimately unsustainable. They want slower growth.



Keene hosts Bloomberg Surveillance *7-10a.m. ET on 1130AM in the NY metro area & nationally on SiriusXM 113.*

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ed all across Arkansas, the U.S.'s prime rice-growing state, where 600,000 acres remain under water one month after flooding began. Nationwide, a spring of weather extremes means that summer has to be almost perfect if the U.S. is to meet global demand for its grain. More bad weather could push corn, the U.S.'s most valuable grain in monetary terms, to $9 a bushel, says Morgan Stanley commodities research chief Hussein Allidina. That would beat the record set in 2008 of almost $8 a bushel.

Floods have damaged up to 6.8 million acres across the South and Midwest, according to the U.S. Army Corps of Engineers, an area equal to the size of Massachusetts. Farmland in other areas is parched, with droughts withering wheat and cotton in the southern plains. Much of Texas, western Oklahoma, southern Kansas, and eastern Colorado have received less than half the normal amount of rainfall in the past 60 days, according to the National Weather Service. About 44 percent of winter wheat fields–which are planted in fall and harvested in June–were in poor condition or worse as of June 5. Ohio's corn crop as of that day was 58 percent planted, the least for the week since 1989. North Dakota's spring wheat crop was 69 percent planted, the slowest pace since 1981.

The price of corn on the Chicago Board of Trade has more than doubled in the past 12 months because of record purchases by ethanol producers and rising demand from livestock farmers. Only 87.2 million acres may be planted with corn this summer, rather than the 92.2 million the U.S. Agriculture Dept. forecast before the flooding, according to the Linn Group, an agricultural researcher in Chicago.

A 5.4 percent drop may not seem like much. With supplies short, though, "we just can't afford to have weather issues, and we've already had quite a few," says Dave Smoldt, a vice-president in West Des Moines for INTL FCStone, a New York-based commodity trading and advisory firm.

U.S. farmers are feverishly working to salvage what land they can before it becomes impossible to plant early enough to ensure a fall harvest. "As soon as that ground comes out of water, they're getting to it as soon as equipment can get on it," says Lee Maddox, spokesman for Tennessee's Farm Bureau Federation. In general, if planting hasn't been done by late June, there's no fall crop.

Many farmers are still waiting to plant. Oxner's land was submerged for three weeks in May, and it's still more than half-covered. "We're just trying to get started," he says. "Every day you can't, that's less you're going to grow." The near-perfect summer he will need for a good harvest seems a long way off.

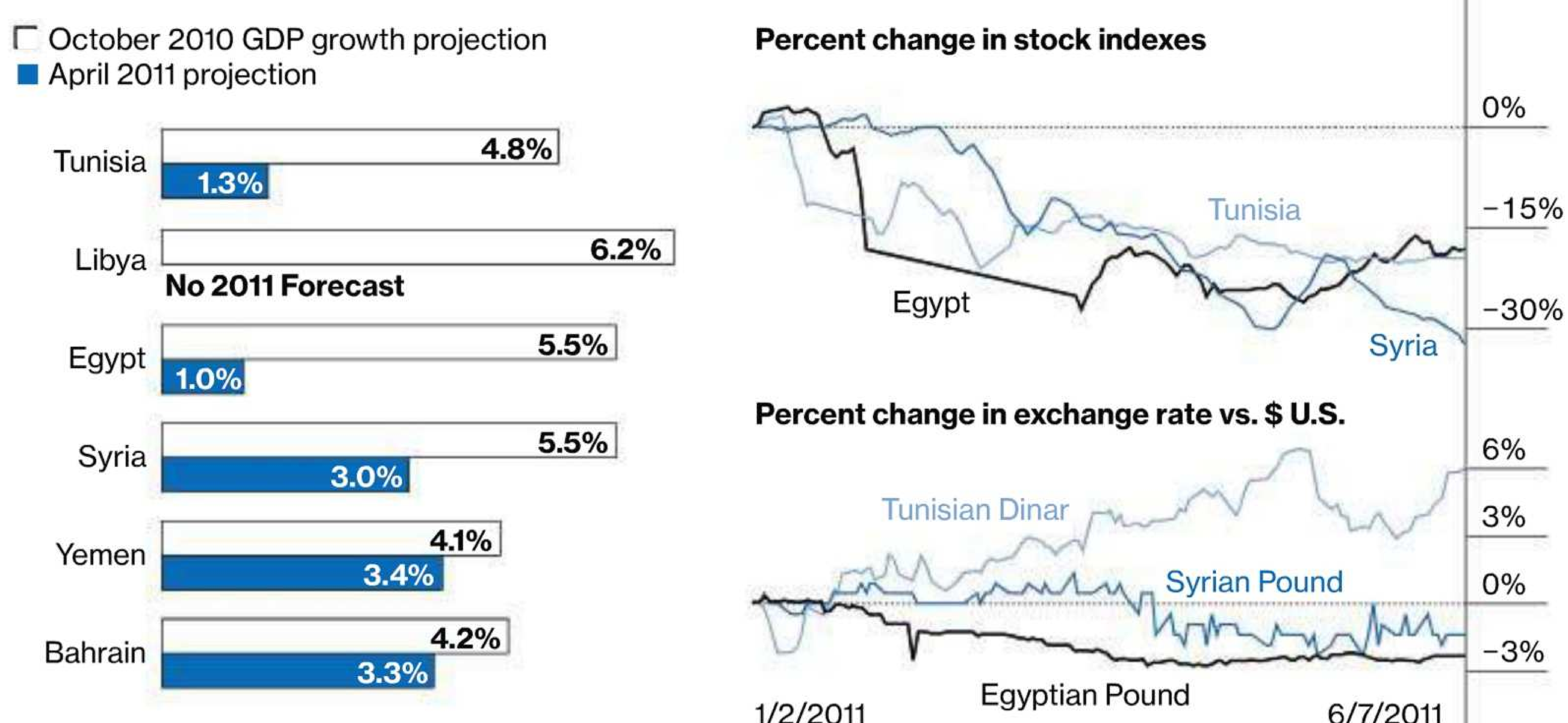
—*Alan Bjerga and Whitney McFerron*

The bottom line *Corn could reach $9 a bushel this summer if farmers can't plant their still-soaked acres in time. Wheat prices will surge, too.*

Insurrections

The Mideast Economy and the Politics of Reform

The Arab Spring has inched into scorching summer, and casualties are mounting in Libya, Yemen, and Syria. There's economic damage, too, as budget deficits jump and tourism and manufacturing suffer. Egypt and Tunisia are receiving significant aid. —*Christopher Power*



DATA: INTERNATIONAL MONETARY FUND, BLOOMBERG

Housing

Where Rents Go, Will Inflation Follow?

▶ Americans leery of buying a home are renting instead

▶ "Landlords have a couple years of ... pricing power over tenants"

Alexander Shevlyagin, a 25-year-old Seattle computer-software manager, says he was shocked to learn in May that his rent was rising to $1,305 a month from $935. "My building manager told me, 'Hey, we're almost at full occupancy,'" Shevlyagin says. "He said he signed the same place I have on a different floor for the new rates, so someone thinks that this is reasonable. I don't consider it reasonable."

The travails of renters like Shevlyagin could become a concern for the Federal Reserve. For now Fed Chair-

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man Ben Bernanke and his colleagues say they will hold rates at record lows, since the slack from 9.1 percent unemployment will help subdue core inflation.

Not everyone agrees. “They should have looked at rents,” says Maury Harris, chief U.S. economist in New York at UBS Securities, whose team was the most accurate inflation forecaster in 2009 and 2010, according to Bloomberg calculations. “They’re putting too much weight on the ‘slack is all that matters’ theory.” Bruce McCain, chief investment strategist at the private-banking unit of KeyCorp, says housing has become “a contributor to inflation, and it continues to rise.” He’s telling clients to adjust their portfolios to counter long-term inflation.

Rent represents about 40 percent of the core consumer price index and made up almost a quarter of April’s 1.3 percent rise. Apartment rents rose 5 percent in the 12 months through April, says researcher Axiometrics. First-quarter cash flow at **AvalonBay**, which owns 50,000 apartments nationwide, climbed 18 percent from the year before. “Landlords have a couple years of runway to have pricing power over their tenants,” says JPMorgan Chase analyst Anthony Paolone.

Rental yields (the rent divided by the property price) will climb in 2011 to the highest level in more than 20 years, predicts Paul Dales, senior U.S. economist in Toronto for Capital Economics. “I’m sure it’s something the Fed is watching, but I wouldn’t be too surprised if they haven’t factored in such a rise,” he says. “It’s possible the Fed may be surprised there.”

While rents weren’t mentioned in the minutes of the Fed’s April meeting, its Apr. 13 Beige Book report on economic conditions was peppered with stories of rising rents in Boston, Chicago, and New York. On June 6 the New York Fed posted on its website a brief item: “The fact that the traditionally more stable components of inflation, such as rents, are the ones driving its increase could be a source of concern.” It’s time, says UBS’s Harris, to raise rates. Otherwise rent increases could trigger inflation that will be hard to stop. “If you have a healthy rate of core inflation,” he says, “you don’t have any business having the federal funds rate under 25 basis points. That’s ridiculous.” —*Joshua Zumbrun*

The bottom line *Some analysts say the Fed may have to pay more attention to rents, which accounted for a quarter of the recent 1.3 percent rise in inflation.*

Events of note in the week ahead

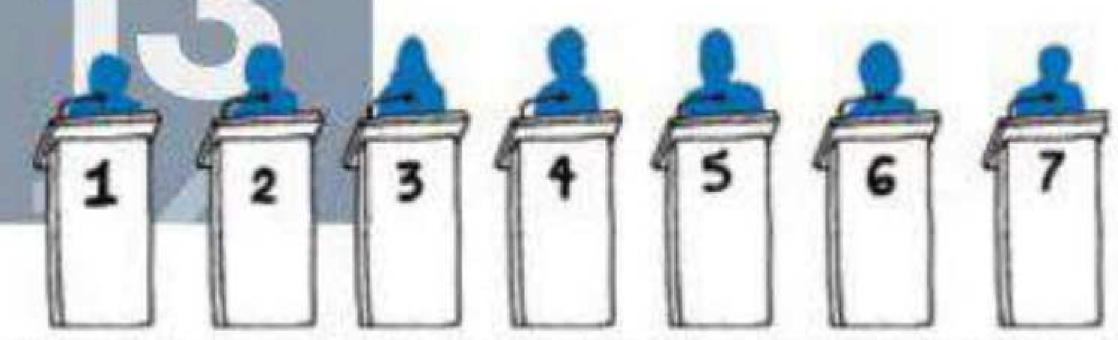
Seven Days

by Ira Boudway

13

China’s consumer price index

▶ GOP debate: Seven Republican Presidential hopefuls—Michele Bachmann, Herman Cain, Newt Gingrich, Ron Paul, Tim Pawlenty, Mitt Romney, and Rick Santorum—meet to debate in New Hampshire.



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U.K.’s leading economic index

Best Buy reports earnings



▶ U.S. retail sales: The pace of growth slowed to 0.5 percent in April as consumers were squeezed by rising prices for food and gas. Surveyed economists expect May sales to shrink by 0.2 percent.



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Art Basel opens

U.S. consumer price index



▶ Shanghai Cooperation Organization: The six-member coalition of China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan gathers for a 10th anniversary summit in Astana to approve a new antidrug strategy.



16

Spain’s leading economic index

Kroger and Pier 1 Imports report earnings



▶ U.S. Open: Englishman Luke Donald, who took over as the world’s top-ranked golfer in late May, joins Lee Westwood and Phil Mickelson among the betting favorites to win in Bethesda, Md.

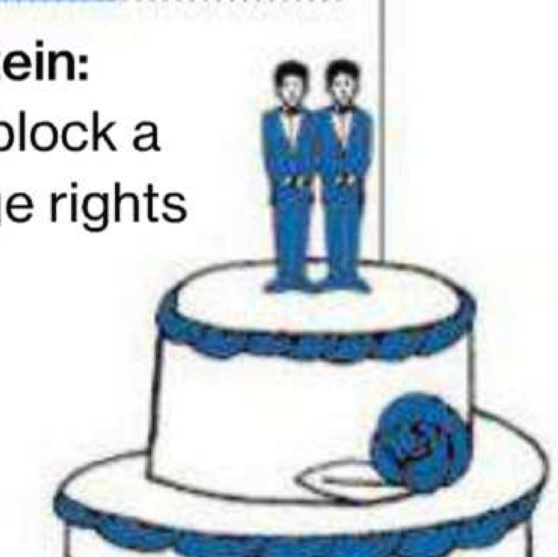


17

Italy’s trade balance

U.S. leading economic index

▶ Referendum in Liechtenstein: Voters decide whether to block a bill to extend most marriage rights to same-sex couples.



18

Soccer: The Under-17 World Cup begins in Mexico



▶ Hollywood auction: Actress Debbie Reynolds puts her collection of film memorabilia up for sale in Beverly Hills. Marilyn Monroe’s “subway dress” from *The Seven Year Itch* is expected to go for as much as $2 million.

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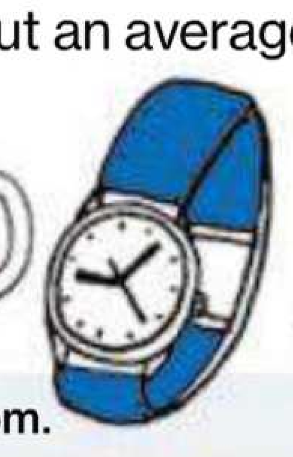
U.K. Rightmove house price survey

▶ Father’s Day: The National Retail Federation forecasts $11.1 billion in spending for the holiday, as Americans shell out an average $106 for dad.









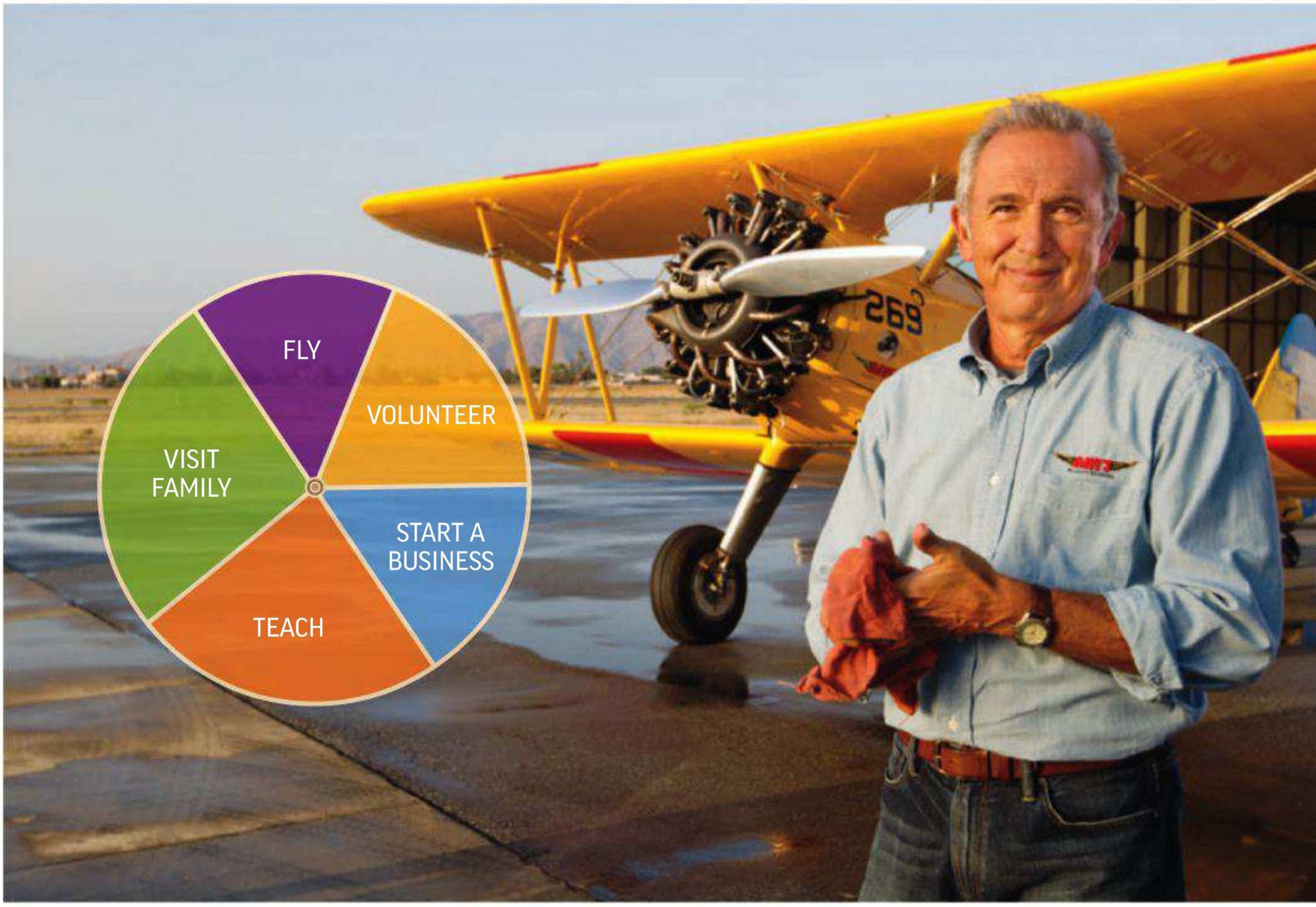


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Procter & Gamble Needs to Shave More Indians

▶ Betting on internal growth, it wants to persuade more people in more places to use its brands

▶ "It's my ... responsibility to figure out how to get our growth goals without an acquisition"

Every Monday morning, **Procter & Gamble** Chief Executive Officer Bob McDonald gathers with a half dozen executives around a football-shaped table at company headquarters in Cincinnati. He and his team gaze up at a 360-degree digital map of the world and plot their next moves. Red areas of the map signal regions where P&G is being challenged by **Unilever, Kimberly-Clark,** and others. Areas where the company is meeting or beating goals are highlighted in green.

McDonald, a graduate of the U.S. Military Academy at West Point, is crafting P&G's strategy as he would a military campaign. After taking P&G's helm two years ago, McDonald, 57, bet he could build the consumer-products giant the hard way—by systematically converting more of the world's people into P&G customers. Unlike his predecessor, A.G. Lafley, who spent $57 billion in 2005 to acquire Gillette—which last year accounted for more than 10 percent of P&G's $78.9 billion in revenue—McDonald isn't hunting for a big acquisition. Instead, he's counting on myriad extensions of existing brands. That means persuading men in India to shave with disposable razors, convincing African women of the benefits of Western feminine hygiene products, and selling more teeth whiteners to Americans.

"It's my and other executives' responsibility to figure out how to get our growth goals without an acquisition," says McDonald, who spent eight of his 31 years at P&G working in Asia, with additional postings in Canada and Europe. "If one comes along, it's serendipitous." Still, he says the bar would be high. "We have so much opportunity that, any acquisition that would come along, we've got to measure the value of that acquisition against, for example, [the potential of] entering oral care in Brazil."

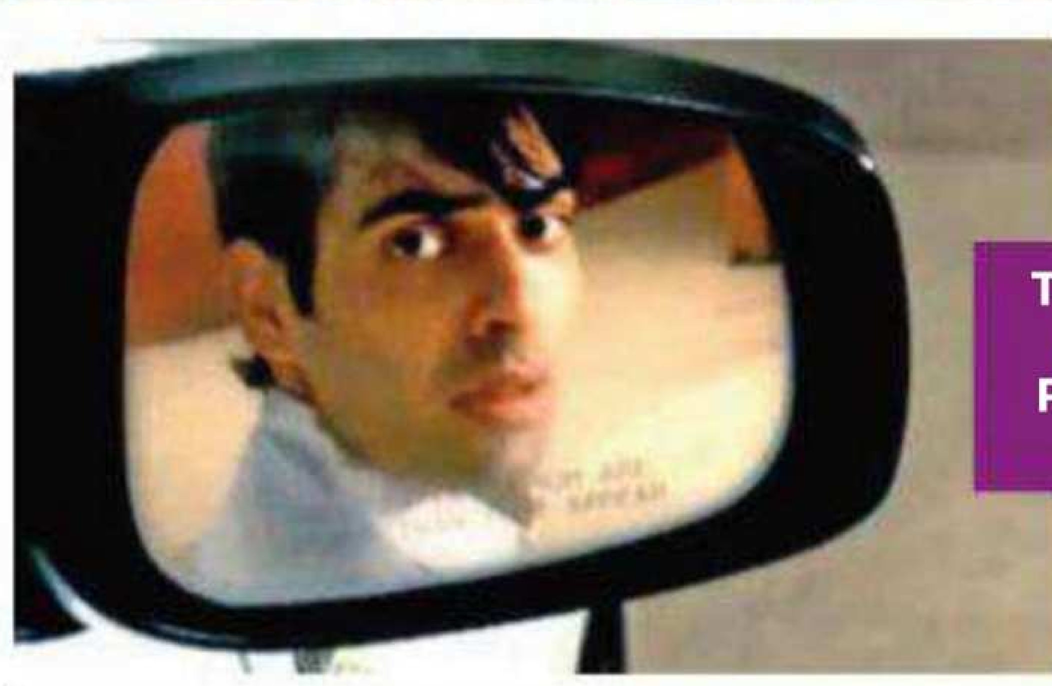


In India, only half of men shave at home, something P&G hopes to change



In one TV ad, women kidnap men with stubble, then shave them





The clean-shaven males look like P&G's customers elsewhere



The sign-off pitches Gillette razors and reminds men that women hate stubble

YOUTUBE (5)

That's why McDonald has adopted a plan of "serving more customers in more parts of the world at both higher and lower price tiers." To do this, McDonald walks the aisles of drugstores and supermarkets as he travels around the world to make sure P&G products are prominently displayed. He regularly e-mails the company's largest retail customers, whether in Boston or Bangalore, as well as ordinary shoppers. And he endlessly analyzes data gleaned from P&G's proprietary computerized marketing information systems, which can crunch up to 10,000 scenarios simultaneously and predict, say, whether premium-priced diapers will be a bust in Morocco or the impact a toothpaste promotion could have in Brazil.

McDonald's focus on internal growth carries plenty of risks. First, P&G's sheer size means it needs a massive flow of new sales—more than the total revenue of competitor **Church & Dwight**, maker of Arm & Hammer products—just to achieve the 4 percent sales growth analysts forecast for this year. The current strategy of expanding further into markets outside the U.S.—already the source of 60 percent of P&G sales—also means the company will have a harder time increasing profits because its foreign margins are lower than those for its American businesses. That's why some investors worry that McDonald's organic growth focus may not be sufficient to jog the company's stock price, which now hovers around $65 a share, well below the $73 mark it hit in December 2007.

"We haven't seen an obvious short-term catalyst that would help them blast through," says Peter Kwiatkowski, a portfolio manager at

WorldMags



The fight over finger-friendly table saws page 32 ▶

Fifth Third Asset Management, which owns 1.9 million P&G shares. "It's difficult at this point to say, 'Wow, this is going to move the needle.'"

McDonald predicts P&G will have 5 billion customers by 2015, up from 4.2 billion last year. It currently offers only half its 38 product categories in many of its top 50 markets. He says pushing consumption of P&G products in China, India, Indonesia, and sub-Saharan Africa to the level the company has reached in Mexico would generate an additional $60 billion in sales annually.

That's why he's working hard to entice emerging market consumers with products that are hits in the West. In India, where 50 percent of men go to barbers when they want a shave, P&G last year launched a "Women Against Lazy Stubble" campaign to increase at-home grooming. It featured surveys indicating that women favored clean-shaven men and television commercials where women in vans snatched men with stubble off the streets and shaved them with Gillette's mid-priced Mach3 razor. The campaign, along with another touting a new, lower-priced razor, helped P&G capture almost half of razor sales in the country in less than two years, it says.

To win over mothers in India to its disposable diapers, P&G chose a marketing pitch different from the one back home. Instead of emphasizing the convenience of Pampers, it highlighted research showing that babies who wear disposable diapers overnight sleep better—and consequently develop better. The result: P&G now has the biggest share of diaper sales there, it says.

While McDonald expects employees to spend time in customers' homes, observing how they mop floors or dye their hair, he's increasingly using technology to gather data. He has joined with **Cisco Systems**, **SAP**, and others to develop IT systems that help P&G decipher its extensive consumer research and sales data for its products. Gazing at their digital map during meetings, P&G executives can click on a country and see what consumers are buying, which promotions are working, where inventory needs to be replenished, and how sales compare to plan.

McDonald and his team in recent months were debating whether to launch a line of lower-priced diapers in Germany when data indicated they'd begin to lose customers within six months without a bigger offensive. So they decided to release the cheaper brand along with a premium line and subsequently captured two-thirds of the market in Germany, an all-time high.

In March, P&G struck an agreement with Israel's **Teva Pharmaceutical Industries**, the world's biggest maker of generic drugs, to jointly develop over-the-counter medicines. The agreement should expand P&G's market for Vicks cough and cold products and other health brands. While the payoff from developing new brands can take longer, McDonald says, it's worth the investment. He's also tiptoeing into providing services with two franchise businesses in the U.S. built around hit P&G products, Mr. Clean Car Washes and Tide Dry Cleaners. They will have 15 and seven of the outlets, respectively, by August.

"I'm not going to argue that the Mr. Clean Car Wash we have here in Cincinnati or the Tide Dry Cleaners stores are the next Swiffer," McDonald says, referring to the hot-selling mop that has become a billion-dollar brand for P&G. "But this is an example of how far afield we're willing to go in order to continue learning and to try new things."

Whatever products P&G launches—often after hefty spending on research—can be quickly copied by private-label manufacturers that offer knockoffs at lower prices. Drugstore operator **CVS Caremark**, for one, sells its own package of 56 teeth-whitening strips for $17, compared with a package of 20 Crest 3D White Whitestrips, which P&G sells for $28. Still, McDonald says he isn't planning to cut the annual research budget of almost $2 billion because it generates new-and-improved products that give P&G an edge. That's one reason, he says, that in the past year "we've grown share in the U.S. and Western Europe while private-label share has been declining in Europe and flat or declining in the U.S."

Such gains come slowly. But Roger L. Jenkins, dean of the Farmer School of Business at Miami University in Ohio, likens McDonald's emphasis on slow and steady growth to the parable of the tortoise and the hare: "Bob is like the tortoise—he's going to get there."
—*Lauren Coleman-Lochner*

The bottom line *P&G must grow 4 percent to meet expectations. Changing consumer behavior abroad is its key strategy.*

$78.9bn

P&G's global sales in 2010. About 60 percent of revenue came from outside the U.S.

Management

For Its 100th Birthday, Will IBM Get a New CEO?

- ▶ Big Blue may choose among execs adept at cost-cutting or growth
- ▶ When it comes to candidates, "they have the problem of riches"

On June 16, **IBM** will mark its centennial. Five weeks later comes a birthday that could be more significant for Big Blue's future: Chief Executive Officer Sam Palmisano turns 60, the age by which IBM CEOs have traditionally named their successors. Who Palmisano ultimately taps to lead the tech giant could go a long way toward determining how much IBM continues the cost-cutting that has marked its recent past or launches into a new era of growth.

On the surface, executive transition shouldn't be traumatic for Big Blue. While **Hewlett-Packard** and **Nokia** have recently had to look outside their ranks to recruit CEOs, IBM has several qualified internal candidates for the job. Sales chief Virginia "Ginni" Rometty and services head Mike Daniels, both senior vice-presidents, are considered the top contenders to follow Palmisano. (A

GETTY IMAGES; OPPOSITE PAGE, BOOTH: DANIEL ACKER/BLOOMBERG

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Who Will Get IBM's Top Job?

CEO Palmisano, who turns 60 on July 29, has transformed IBM from a hardware maker into a software and services giant

Rometty, 53, runs the company's sales operation and is known for her extreme work ethic. If picked, it may signal an emphasis on growth

Daniels, 56, heads IBM's services business. Cost-cutting has been his focus in recent years, which has helped raise profits faster than sales



third candidate, hardware chief Rodney C. Adkins, is considered a long shot by analysts.) "They've mastered the art of developing the next generation," says Dennis Carey, vice-chairman at executive recruiter Korn/Ferry International, which has done work for IBM. "Now they have the problem of riches, as opposed to the problem of poverty."

Rometty, 53, runs IBM's sales operations and previously led services, which has become the company's most important business. A 30-year IBM veteran, she caught Palmisano's eye helping to integrate PricewaterhouseCoopers (PwC), a $3.9 billion acquisition that allowed the company to offer strategic advice. That, in turn, enabled IBM to forge closer ties to customers' CEOs. If chosen, Rometty would be the company's first female chief executive. She'd also make IBM the largest company with a woman at the helm, surpassing **PepsiCo**, headed by Indra Nooyi.

"I don't think it's a race," says John Swainson, who spent 26 years at IBM and is now a senior adviser at Silver Lake Partners. "If they were going to choose someone now to be Sam's replacement, she'd be the logical choice." Swainson says overseeing sales is particularly significant. "That, historically at IBM, has been the big job before running the whole company," he says. Palmisano took over sales when he was named president in 2000 and succeeded Louis Gerstner two years later.

After the PwC acquisition, Rometty helped retain its consultants by shielding them from some of IBM's cost-cutting. When Palmisano wanted to trim travel budgets by making consultants stay at economy hotels like Holiday Inns, she helped them fight the move—and win—says Milestone Partners' Ric Andersen, then a PwC consultant. "She knows how to interact with him," he says. "Sam can crush people. He's a very fiery, driven kind of guy. She knows there are times to take on battles and times to not."

Daniels, 56, joined IBM straight out of college. His trajectory is similar to Rometty's, with experience in sales and services, plus a key posting in Tokyo. He now runs all of services, where he's responsible for about 60 percent of IBM's total revenue. He's known as an affable manager, with a less intense personality than Rometty or Palmisano. "He just gets business done, without a lot of fireworks," says Frank Gens, an analyst at research firm IDC.

Daniels in recent years has made his mark as a cost-cutter, helping boost IBM's margins. In 2005, when Palmisano split the services business into consulting and technology units, Daniels at first took over only the latter. He fired thousands of people and offshored jobs to lower-cost regions such as India to trim expenses and boost profits. The moves helped IBM thrive against rivals. Still, some workers resent his decisions. "We really feel like we're treated like a number," says Tom Midgley, president of Alliance@IBM, an employee group that's tried to unionize IBM's workers.

Who ends up succeeding Palmisano may well depend on what the board decides are the top priorities going forward. Palmisano steadily transformed IBM from the world's largest computer maker into a services and software company. He sold off the PC business in 2005 and made $25 billion in acquisitions. That rendered the company reliably profitable but also a slow-growth operation. While rising earnings have pushed IBM's stock to an all-time high, its sales growth over the past nine years has been only half that of HP and **Oracle**.

Whether IBM's board decides that faster growth is the priority for the second half of the decade (a financial strategy is already mapped out through 2015) or that a seasoned cost-cutter is needed to keep profits steady, directors aren't eager to lose either Rometty or Daniels. The board has approved hefty incentive packages for both—as long as they stay put for another three years.

—Katie Hoffmann, with Carol Hymowitz and Jeff Green

The bottom line *Palmisano's choice of a successor will help determine whether IBM continues to focus on costs or tries to move in a new direction.*

Quoted

"Growth is a new skill to learn for us. We've been good at restructuring businesses over the last decade. Growth takes practice."

—Lewis Booth, Ford Motor's chief financial officer, on the automaker's forecast that it will boost global sales 50 percent, to 8 million vehicles annually, by 2015



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Global Brands

Some Chinese Kids' First English Word: Mickey

▶ Disney's language schools thrive in the English-hungry mainland

▶ "They're starting years early, brainwashing Chinese children"

Five-year-old Wei Ziyun chose "Robot" as his English name after the title character in the **Walt Disney** movie *Wall-E*. Now a Disney English learning center in Shanghai is teaching him how to spell it. "Robot" and his classmates are learning the colors of the fish on Mickey Mouse's boat and the articles of clothing Goofy needs when the weather gets cold. They should be more than proficient in English by the time the $4.4 billion Shanghai Disney Resort opens in about five years. "I want to come here every day," the boy says after one of his twice-weekly lessons. "It's fun to learn English."

Disney opened its first English-language academy in China in 2008, and demand for English instruction has increased so much that the company has in the past year tripled the number of its schools, to 22. "It's a very efficient way of marketing their brand as well as the amusement park," says Shang Yang, chairman of Shangyang Enterprise Management Consulting. "They're starting years early, brainwashing Chinese children and cultivating them as potential clients in a very indirect, yet penetrative, fashion."

China's private education market, including international schools, is projected to grow to 517 billion yuan ($79.6 billion) by 2012 from 356 billion yuan in 2009, according to Merrill Lynch. Andrew Sugerman, Disney English's general manager, says the market for children's English-language learning in China may increase 29 percent annually over the next four years from the current 24 billion yuan. Sugerman declined to give financial details about Disney English except to say that it's profitable. Besides Shanghai, there are learning centers in Beijing, Hangzhou, Nanjing, Ningbo, Tianjin, and Suzhou. Although Disney eventually may expand the business outside the mainland, Sugerman says all the company's focus currently is geared toward China.

29%

Annual growth forecast for kids' English instruction in China until 2015

"Being surrounded by all sorts of Disney products and characters, it's almost impossible for children and their parents not to love Disney," says Wang Bing, an analyst at Phillip Securities Research in Shanghai.

The private education market is highly fragmented in China. **New Oriental Education & Technology Group** in Beijing, the nation's largest operator, had less than a 1 percent share in 2009, according to Merrill Lynch. New Oriental made about $64 million from children's English training last year, up more than 35 percent from a year earlier, says President Louis Hsieh. He expects New Oriental's English training program for kids to grow by at least 40 percent during the next couple of years. Learning English is "seen as an absolutely necessary skill to get a good-paying job," he says.



Absorbing the ABC's and Mickey at Disney English in Shanghai



Marching to class down a hallway lined with Disney characters

Disney English worked with an academic advisory board to create its Disney Immersive Storytelling Approach, producing more than 300 songs for the program. Sugerman says the curriculum follows standards set by Chinese education ministries. A team of 10 Los Angeles-based staffers creates additional culturally relevant content.

Disney charges 3,000 yuan to 12,000 yuan annually for the programs, which include separate curriculums for 2- to 4-year-olds, 3- to 6-year-olds, and primary-school students. Classes typically last 45 minutes and are taught by a native English speaker, certified in teaching English as a foreign language, and a Chinese-speaking assistant. When it's time to start, kids march down a hallway decorated with characters from Disney films including *Bolt* and *Ratatouille* to classrooms filled with references to *The Lion King* and *Mulan*, a Disney tale about a Chinese warrior princess.

KEVIN LEE/BLOOMBERG (2); OPPOSITE PAGE: MICHAEL BUSH/UPI/LANDOV

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Kids are tested every six weeks on their reading, writing, speaking, and listening comprehension. They also can study at home, with materials featuring characters including Mickey Mouse, Winnie the Pooh, and the gang from the film *Monsters, Inc.* Says Mary Bergstrom, founder of Bergstrom Group, a Shanghai consultancy: "What Disney is doing now in China is growing a future consumer base."
—*Michael Wei and Margaret Conley*

The bottom line *Disney is using animated characters to grab a piece of the $3.7 billion market in English-language training for kids in China.*

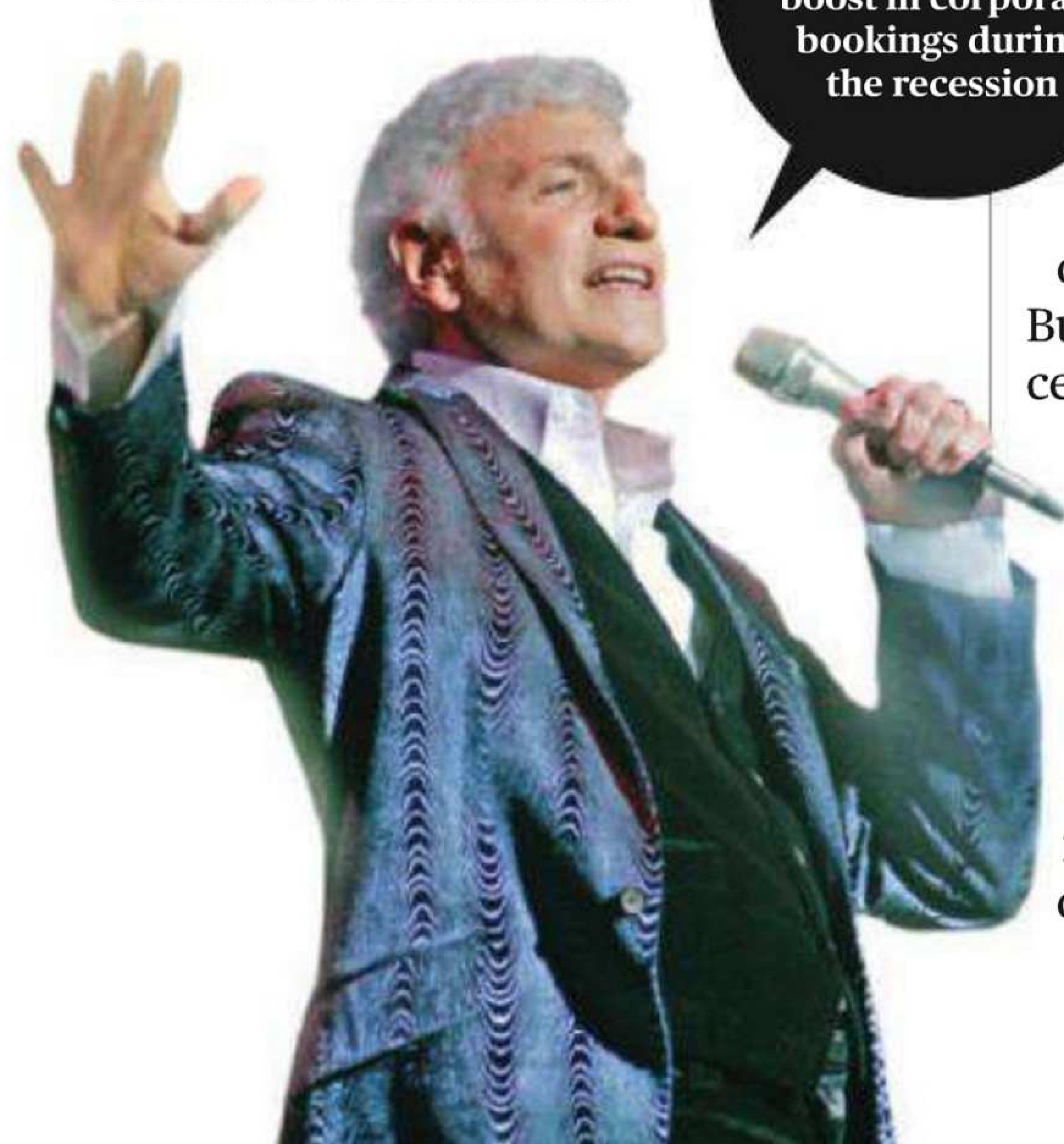
Retreats

Business Slowly Starts To Party Again

▶ As the economy rebounds, toned-down corporate events return

▶ "People are definitely more careful about being flashy," says a booker

Thanks to corporate belt-tightening, the Great Recession turned out to be a boon for Dennis DeYoung, the former frontman for the '70s rock band Styx. In 2009, DeYoung performed at more than 15 corporate shows for clients such as **Honda Motor**'s U.S. unit and **Resurrection Health Care**, offering hit songs such as *Lady*, *Come Sail Away*, and *Mr. Roboto* without the Styx price, says Tim Orchard, who manages the star. Unfortunately for DeYoung, the number of his corporate bookings continues to be a reverse indicator of Corporate America's fortunes. This year the singer, who charges about $50,000 a show, will do only six to eight corporate gigs as company entertainment budgets grow–allowing event planners to tap more expensive talent. "The $1 million corporate events are coming back," Orchard says. "There are fewer people looking for value."



Former Styx frontman Dennis DeYoung saw a boost in corporate bookings during the recession

Event planners agree that chief financial officers are finally loosening the purse strings for corporate events and retreats. **General Electric** in January returned to the tony Boca Raton (Fla.) Resort for its annual leadership meeting of top executives. For the previous two years, GE held the gathering at its in-house training center outside New York City. Software developer **Ipswitch**, whose sales increased during the recession, this year spent about $1 million to take some 500 employees and guests for a long weekend at The Breakers in Palm Beach, Fla., to celebrate its 20th anniversary. With resorts still hurting from the downturn, Chief Executive Officer Roger Greene says, the affair was a bargain compared with what Ipswitch paid when it took employees on an ocean cruise to mark the company's 10th birthday.

Although spending is picking up, there are differences this time around. "On the corporate side ... people are definitely more careful about being flashy," says Steve Einzig, owner of **BookingEntertainment.com** and a former agent for the late singer James Brown. **Vocus**, a maker of Web-based public-relations software in Lanham, Md., isn't bringing back the annual party cruise for 300 employees it stopped doing in 2009, even though sales growth has recently rebounded. "It was a lot of fun," says Chief Operating Officer Bill Wagner, but "there's no more boat trip." Vocus is instead retaining its quarterly nights out at a rented bowling alley or Dave & Buster's arcade while adding a massage center, half-court basketball court, and game room at its new offices.

Spending on corporate events likely won't recover to pre-2009 levels until 2012, says Brian Ludwig, vice-president for **Cvent**, an Internet service that matches event planners with venues. Even if profits have rebounded, companies are wary of extravagant shows, says Bob

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Asbestos roof sheets like these can cost as little as $7 in India

ADEEL HALIM/BLOOMBERG

J. Grabow, CEO of **Grabow & Associates**, an entertainment booking agency. "If they had to lay off 10 percent of their people or more, how does it look to hold a big event?" he says.

Engineering giant **Fluor** will fly about 600 executives to Texas in August for a "low-key" meeting that will likely include entertainment, says communications chief Keith Stephens, who declined to give details. Fluor normally holds the meeting every 18 to 36 months but has let five years elapse since the last one because of the recession and cost-cutting, Stephens says. "We were focused on weeding out nonessential or discretionary expenses," he explains.

28%

Share of event managers hiking spending, says *Exhibitor* magazine

Corporate cuts caused hunting customers to drop by half at Rough Creek Lodge and Resort in Texas during the recession. At $645 per person to hunt quail and pheasant for three and a half hours on weekends, companies found the activity an easy one to cut, says Teka Paul, wildlife manager at the resort in Glen Rose, Tex., about 85 miles southwest of Dallas. To draw new business, the resort now offers less costly activities such as a GPS scavenger hunt at $152 per team of five or less and horseback riding at $62 an hour.
—*Thomas Black*

***The bottom line** Corporate entertainment spending tanked during the Great Recession. Its gradual return has squeezed discount acts.*

Workplace

In India, Slum Roofing Is Cheap—and Deadly

▶ The top importer of asbestos, India is lax on factory regulations

▶ "I will have to study the impact," says one minister

Rajendra Pevekar, a butcher in a working-class Mumbai neighborhood, remembers falling asleep on his father's chest as a child and seeing shiny specks of dust on the older man's clothes. What Pevekar, 45, didn't know was that the dust has a name–asbestos–and a record of wrecking the lungs of those who inhale it. His father unintentionally carried the fibers home from his job at a Mumbai auto-parts factory owned by British manufacturer Turner & Newall. Only last year, after attending an event organized by a nonprofit public-health group, did Pevekar draw a connection between the dust, his father's early death, his mother's debilitating shortness of breath, and his own pulmonary problems. "This is a slow poison," says Pevekar. "It destroys your lungs, and you don't even know it."

Pevekar's mother was among the first Indians last December to get paid about 700,000 rupees ($15,600)–more than 10 times her son's annual income–from a trust established by Turner & Newall, which went bankrupt in 2001 under the weight of asbestos-related litigation, to compensate workers and their families affected by asbestosis. An additional 40 workers received payouts in May, bringing the total to 104 million rupees.

The lessons learned by richer nations, which began banning asbestos in factories in the 1970s, are slow to take hold in India, where demand for cheap building materials for millions of slum dwellers has overpowered concerns about worker safety. Asbestos fibers can bruise the lung tissue, leaving scars that cripple the organ's ability to process oxygen and sometimes cause lung cancer.

India is the world's largest importer of asbestos, according to U.N. data, and the shipments received from Russia, Canada, and Brazil mostly go into making corrugated roofing sheets, a fixture in Indian slum dwellings that sell for as little as 300 rupees. More than 100,000 Indians are employed by companies using asbestos, according to an industry lobbying group. "It is totally outrageous," says Gopal Krishna, founder of the Ban Asbestos Network of India. "We've known that this stuff is deadly for many years, and the government is not banning it."

The Indian government requires factories to ensure that workers aren't exposed to air containing more than one fiber per cubic centimeter, a level 10 times the maximum limit in the U.S. Yet regulation is lax and inspections infrequent, says Jagdish Parikh, a retired deputy director of the National Institute of Occupational Health in the west Indian city of Ahmedabad. India's ministries of health and labor declined to comment. When asked whether asbestos should be banned, Environment Minister Jairam Ramesh says, "I will have to study the impact. I haven't been able to put my mind to it yet."

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Companies&Industries

At **Everest Industries**' roof factory in the village of Lakhmapur, a four-hour drive from Mumbai, asbestos and other materials are mixed together in giant vats. Only two of about two dozen employees seen on a recent visit were wearing face masks. Many of the workers' clothes carried traces of gray dust, and the cavernous shop floor had no visible exhaust system. "It is a well-ventilated area, as per the requirement," says K.K. Rameshan, the plant's general manager. "No exhaust system is needed here."

100 THOUSAND

Indians employed in industries that use asbestos

When workers suffer health problems, the process for seeking compensation is arduous. Patients need a certificate from the government-run Employees' State Insurance Corp. to be eligible for disability benefits. Through 2009, only 54 asbestos workers had received compensation from the agency, says Madhumita Dutta from the Ban Asbestos Network in Chennai. Some employees don't apply for fear of losing their jobs, and others are frustrated by bureaucratic hurdles, says Raghunath Manwar, a union activist who is trying to help workers at a factory owned by **Gujarat Composites** in Ahmedabad get compensation for asbestos-related health problems. "I have been going to the government office for the last five years, but they keep sending me back," says Chinnappan Chinnakannu, 57, one of the workers Manwar is helping. D.K. Dutta, the general manager of the Gujarat factory in Ahmedabad, says, "We maintain all the safety procedures that are required."

While growing up, Pevekar, the butcher, shared a single room with his father, mother, and four siblings. They all inhaled fine asbestos particles from the elder Pevekar's clothes, he recalls. Decades later, Pevekar can't climb more than two flights of steps. "I worry about living long enough and well enough to take care of my children," he says. "I want our lives back." Ⓑ

—*Adi Narayan and Andrew MacAskill*

The bottom line *Indian workers affected by asbestos struggle to collect compensation from the government, which has approved payment in only 54 cases.*

Briefs

by Karen Weise

McDonald's
Slow growth in a tough economy



Same-store sales at McDonald's restaurants rose 3.1 percent in May, falling shy of analysts' median estimate of 3.6 percent. It was the fast-food chain's slowest growth in more than a year. Weak consumer spending and a national unemployment rate of 9.1 percent contributed to the sluggish sales. Analysts also cited rising gas prices and the fact that there were fewer weekends this May than last year. At the same time, the cost of ingredients jumped because of rising grain and meat prices over the past year. Meat prices may rise 7 percent this year, according to the U.S. Agriculture Dept. McDonald's is trying to lure customers this summer with new products, including frozen-strawberry lemonade.

Medco Health Solutions
Looking to buy



Medco, the largest pharmacy benefits manager, may lose its top client, forcing it to seek acquisitions to make up for lost revenue. Medco has lost $3.5 billion in contracts since March. UnitedHealth says it is considering bringing its benefits management in-house when its $11 billion contract with Medco expires next year. If it does, Medco would likely drop from the largest pharmacy benefits manager to the smallest, says Helene Wolk, an analyst at Sanford C. Bernstein. She says Cigna's pharmacy unit is a potential acquisition target.

Capital One/GE
Two bids to buy ING's online bank

General Electric and Capital One both submitted offers to buy ING's online bank for up to $9 billion, according to people with direct knowledge of the matter. ING is selling its online-only bank—the largest in the U.S.—as part of a restructuring plan mandated by European regulators after the bank received state aid during the financial crisis. GE, which offered cash, wants the bank to gain its large deposit base. Capital One's offer included stock and would make Amsterdam-based ING one of the credit-card company's largest shareholders.

GE/Nucor
China ends wind power subsidies



Responding to a complaint filed with the World Trade Organization, China agreed to end subsidies for win power manufacturing totaling hundreds of millions of dollars. China has aided local manufacturers with as much as $22.5 million each if they used parts made in China. The U.S. Trade Representative's office, supported by groups representing manufacturers such as General Electric and Nucor, submitted a complaint to the WTO, saying the practice violated international trade laws and harmed component manufacturers outside China.

Facebook
EU probes facial recognition feature



European regulators said they will investigate Facebook's use of facial recognition technology, which does not ask permission from users. A privacy group in the U.S. plans to ask the Federal Trade Commission to examine the issue, too. When users upload photos, Facebook's feature, called Tag Suggestions, analyzes the images and suggests people's names to tag in the pictures. Privacy watchdogs say the feature should require prior consent. Facebook says users add 100 million tags each day and people can easily opt out.

On the Move

Procter & Gamble Charles Bergh, global male grooming president, to leave in September • Chrysler Reid Bigland named CEO of Dodge brand and U.S. sales • *New York Times* Jill Abramson named first female executive editor •

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4. Of your overnight and 2–3 day shipments, about what percentage are boxes compared to envelopes?
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☐ 50% boxes/50% envs. ☐ 75% boxes/25% envelopes
☐ 100% envelopes

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Politics&Policy

The Loneliest Republicans In Washington

▶ **As a deadline nears, two lawmakers urge their colleagues to get serious about the debt**

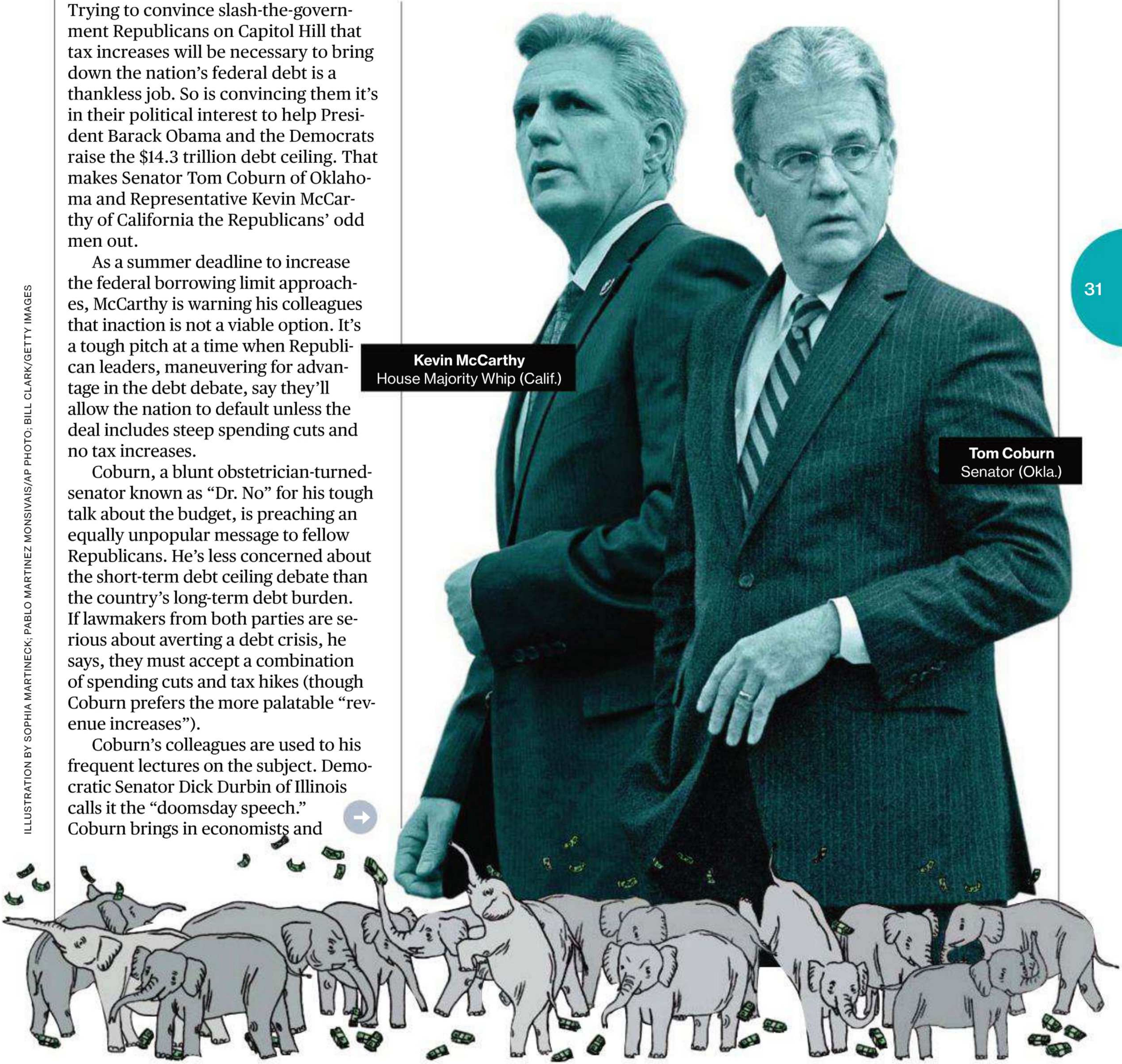
▶ **"We have to allow the other side some type of win"**

Trying to convince slash-the-government Republicans on Capitol Hill that tax increases will be necessary to bring down the nation's federal debt is a thankless job. So is convincing them it's in their political interest to help President Barack Obama and the Democrats raise the $14.3 trillion debt ceiling. That makes Senator Tom Coburn of Oklahoma and Representative Kevin McCarthy of California the Republicans' odd men out.

As a summer deadline to increase the federal borrowing limit approaches, McCarthy is warning his colleagues that inaction is not a viable option. It's a tough pitch at a time when Republican leaders, maneuvering for advantage in the debt debate, say they'll allow the nation to default unless the deal includes steep spending cuts and no tax increases.

Coburn, a blunt obstetrician-turned-senator known as "Dr. No" for his tough talk about the budget, is preaching an equally unpopular message to fellow Republicans. He's less concerned about the short-term debt ceiling debate than the country's long-term debt burden. If lawmakers from both parties are serious about averting a debt crisis, he says, they must accept a combination of spending cuts and tax hikes (though Coburn prefers the more palatable "revenue increases").

Coburn's colleagues are used to his frequent lectures on the subject. Democratic Senator Dick Durbin of Illinois calls it the "doomsday speech." Coburn brings in economists and



Kevin McCarthy
House Majority Whip (Calif.)

Tom Coburn
Senator (Okla.)

ILLUSTRATION BY SOPHIA MARTINECK; PABLO MARTINEZ MONSIVAIS/AP PHOTO; BILL CLARK/GETTY IMAGES



Wall Street executives to spell out for senators how the rapidly expanding debt threatens prosperity. Republican Senator Bob Corker (Tenn.) attended one of Coburn's productions earlier this year. The guest speakers were two hedge fund managers—a Democrat and a Republican. Corker says they made a pretty convincing pitch: "These practitioners, they deal with markets on a daily basis. And you had one from each side of the aisle saying the same thing, which was that we have to deal with this issue." Republican Senator Mark Kirk (Ill.), who attended another Coburn session, said by the time it was over, "You could see a lot of light bulbs going off in other senators' heads."

McCarthy, a third-termer who once ran a sandwich shop and now is his party's No. 3 leader in the House, is a bit subtler in his efforts to persuade conservative members to support a debt ceiling increase. Congress must act by Aug. 2, according to Treasury Secretary Timothy F. Geithner, to avoid an unprecedented default. As the party whip in the raucous and polarized House, McCarthy has the job of creating the political space for leaders to negotiate a deal. While his bosses, including House Speaker John Boehner (Ohio), make a public show of saying they're against it, McCarthy is working quietly to begin getting members in line. This good-cop-bad-cop routine lets the speaker publicly keep up pressure on the Democrats—and maintain street cred with scores of Republican lawmakers who are either loyal to or fearful of antitax Tea Partiers.

At the moment it seems unlikely that McCarthy has anywhere near the 218 Republican votes he'll need to pass a deal. Like Coburn, he routinely corners fellow Republicans with a chart-heavy presentation on the basics of the debt. He also takes lawmakers on field trips to federal bond auctions at the Bureau of the Public Debt in downtown Washington, where they can watch the U.S. go into debt in real time.

For their efforts, Coburn and McCarthy have earned the ire of powerful forces within their party. "Kevin's in a tough spot," says Republican Representative Sean Duffy (Wis.), elected last fall with Tea Party support. "He's going to have to work our people very hard and make a very persuasive case as to why we should go along with this." The usually gregarious McCarthy, 46, declined to be interviewed for this story.

Coburn, 63, is tangled in a heated public spat with the influential antitax crusader Grover Norquist, head of Americans for Tax Reform, who recently compared him to a malignant cell. Coburn, a cancer survivor, said he doesn't take the criticism personally. "I'm just sorry that he feels that he has to say those things," he said in an interview in his office. "I recognize that if we're ever going to accomplish anything, we have to allow the other side some type of win. ... We have to be able to compromise in terms of using revenues if we want to reform things like Medicare and Social Security."

Coburn says there's little chance of getting Republicans to go along with such a compromise unless Democrats are willing to make aggressive cuts in government spending. So far, he says, he hasn't seen it. Until recently he was one of three Republican members of a bipartisan group, known as the Gang of Six, working on a proposal to shave some $3.8 trillion off the debt through cuts to entitlements and tax increases. He left last month, saying Democrats weren't willing to cut enough from Medicare and other programs. Coburn says he can't blame his colleagues for being wary of any deal that doesn't reduce the size of the government. "If you vote to raise this debt limit and haven't fixed the problem," he says, "I think you're history." *—Julie Hirschfeld Davis*

***The bottom line** As Republicans threaten to let the U.S. default, their leaders are quietly seeking support for a debt deal with the Democrats.*

Consumer Safety

A Fight Over Finger-Friendly Table Saws

▶ An inventor lobbies the government to require a device that stops blades

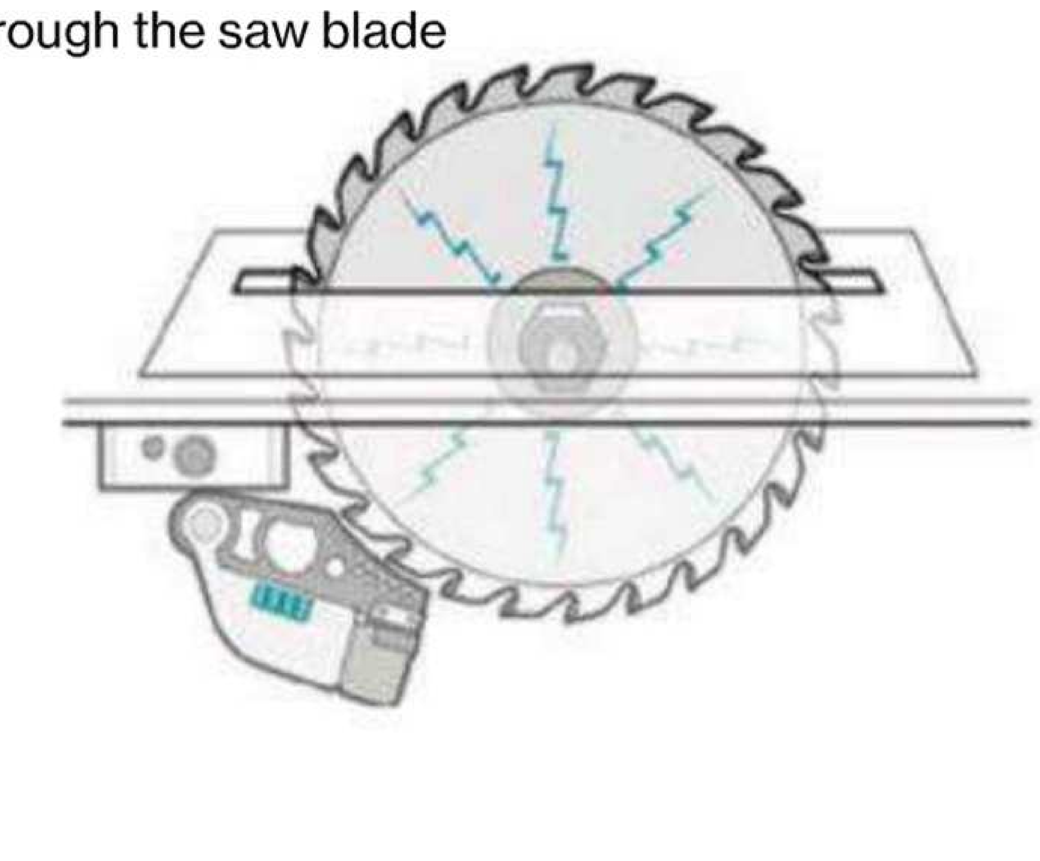
▶ "He wants to make sure the only option is his technology"

Chris Hackler was making routine cuts on his front porch table saw earlier this year when the wood jammed and yanked his hand into the spinning blade. In an instant, the Enola (Ark.) preacher lost the tips of two fingers. Hackler is one of an estimated 4,000 Americans who will lose a finger, hand, or arm while using the tool this year. What most of them probably don't know is that technology exists that could prevent injuries. It isn't being put to use in many saws on the market, in part because of a long-running dispute over whether the federal government should force saw

GEORGE DOYLE/GETTY IMAGES; ILLUSTRATION BY BROWN BIRD DESIGN

How to Stop a Saw Cold

1) An electric current runs through the saw blade



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companies to include a safety device in their products.

SawStop, a small manufacturer in Tualatin, Ore., markets a line of table saws equipped with a sensor system that immediately halts and retracts a saw blade when it contacts flesh. Its founder, Stephen Gass, an inventor and—importantly—a patent lawyer, likes to demonstrate his product by pushing a hot dog into a whirring blade. The weenie comes away with barely a scratch.

For eight years, Gass has lobbied the U.S. Consumer Product Safety Commission to require all table saws sold in the U.S. to be equipped with SawStop or a similar safety device. Agency officials have studied the question but stopped short of acting. They may soon take it up again, and if they impose the requirement, that will make Gass a happy—and potentially rich—man.

His rivals are anything but happy. The Power Tool Institute, a Cleveland-based trade group of major manufacturers including **Robert Bosch**, **Stanley Black & Decker**, **Ryobi**, and **Techtronic Industries**, is fighting Gass's efforts. They say requiring a blade brake would destroy the market for the cheapest, most popular saws, adding $100 or more to the price of consumer models that typically sell for less than $200. The CPSC puts the industry's cost at about $70 million a year.

A saw brake requirement would amount to a government-granted monopoly for Gass, the companies argue. Although in theory saw makers could develop their own versions, they say Gass has so effectively locked up the process with patents that they would be forced to license the system from him or risk getting sued for infringement. "He wants to make sure the only option is his technology," says Edward D. Krenik, the Power Tool Institute's lobbyist in Washington.

Gass says he approached major saw manufacturers a decade ago and tried to sell them on his product. When they turned him away, he took his case to the government. "The rulemaking should be about protecting customers," Gass says. "Whether SawStop has a windfall or goes broke shouldn't make any difference."

He has found at least one sympathetic ear at the commission. In March he demonstrated his invention for Robert S. Adler, a former University of North Carolina business professor and recent Barack Obama appointee to the CPSC. "I couldn't believe anything could work that fast," says Adler, who is now in favor of revisiting the issue. CPSC Chairman Inez Tenenbaum says in an e-mail that she will decide whether to recommend moving ahead in the next few months.

Power tool manufacturers intend to fight all the way. In place of federal rules, they are pushing for stronger voluntary measures. Newer table saws are made with improved blade guards and other safety devices that they say protect users at a much lower cost.

Adler is hopeful Gass and the industry can still work out a deal. But he says brokering peace is less important to him than protecting woodworkers' fingers. "There's [products] you look at one day and say, there's not a damn thing we can do about it," Adler says. "Then somebody comes along and invents a technology and changes the picture."
—Jeff Plungis

The bottom line *Mandating safety blades on table saws could save thousands of hands a year. It could also price the tools beyond many people's reach.*

Law

The Crimson Ties That Bind

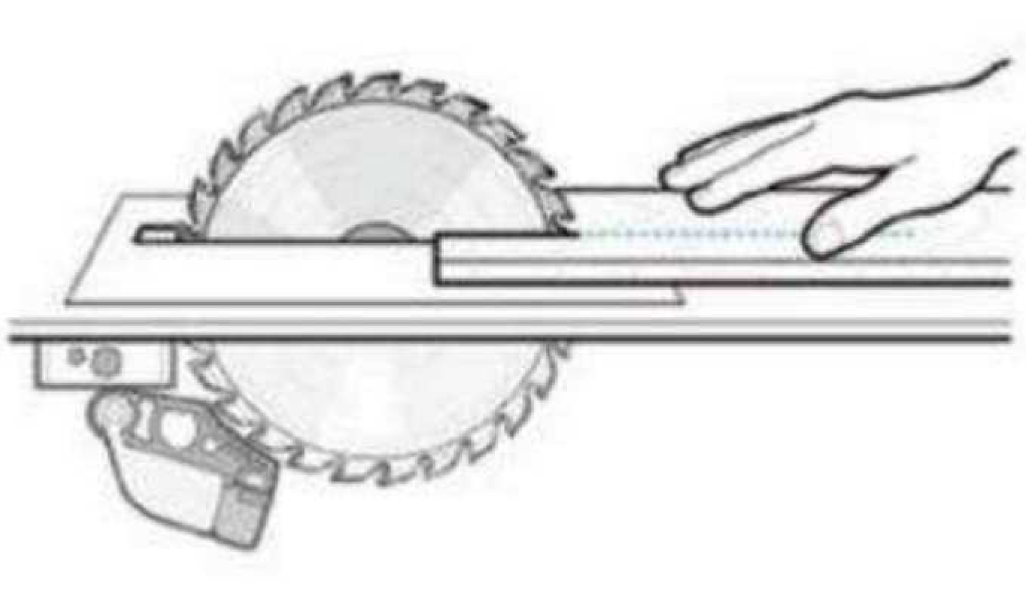
▶ Bancroft has become a go-to law firm for conservative causes

▶ "If you really practice law, you can tick off everybody"

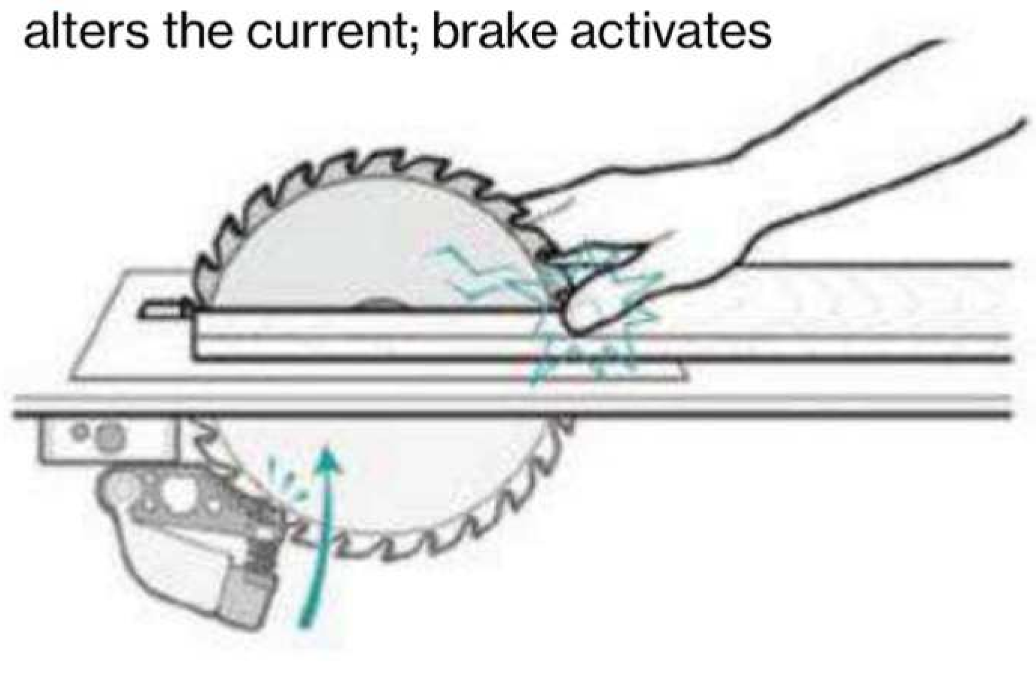
Paul Clement's ability to land on his feet has amazed even his critics. He left his white-shoe law firm after it withdrew as counsel to the House of Representatives in defending the 15-year-old Defense of Marriage Act, a client Clement brought to the firm. Clement found a new job so fast that when a small band of supporters of same-sex marriage showed up outside his new office in late April to hand out printed flyers, they'd only had time to cross out the name of his old firm, King & Spalding, and write in the new one, Bancroft.

Clement walked out on King & Spalding after his representation drew complaints from longtime clients,

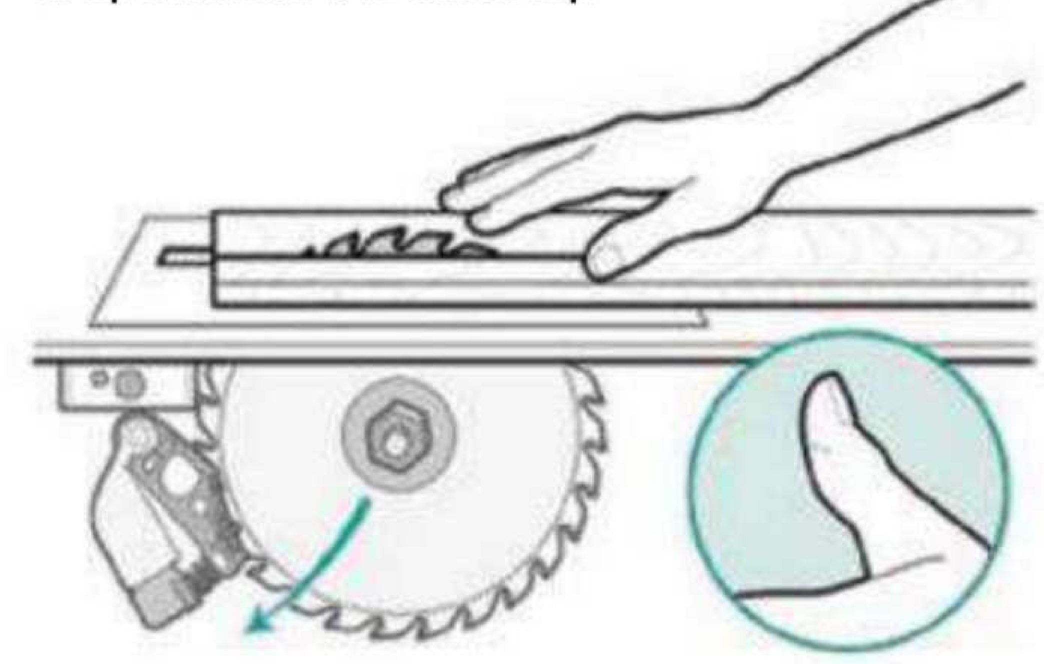
2) Wood does not affect the current; the blade keeps spinning



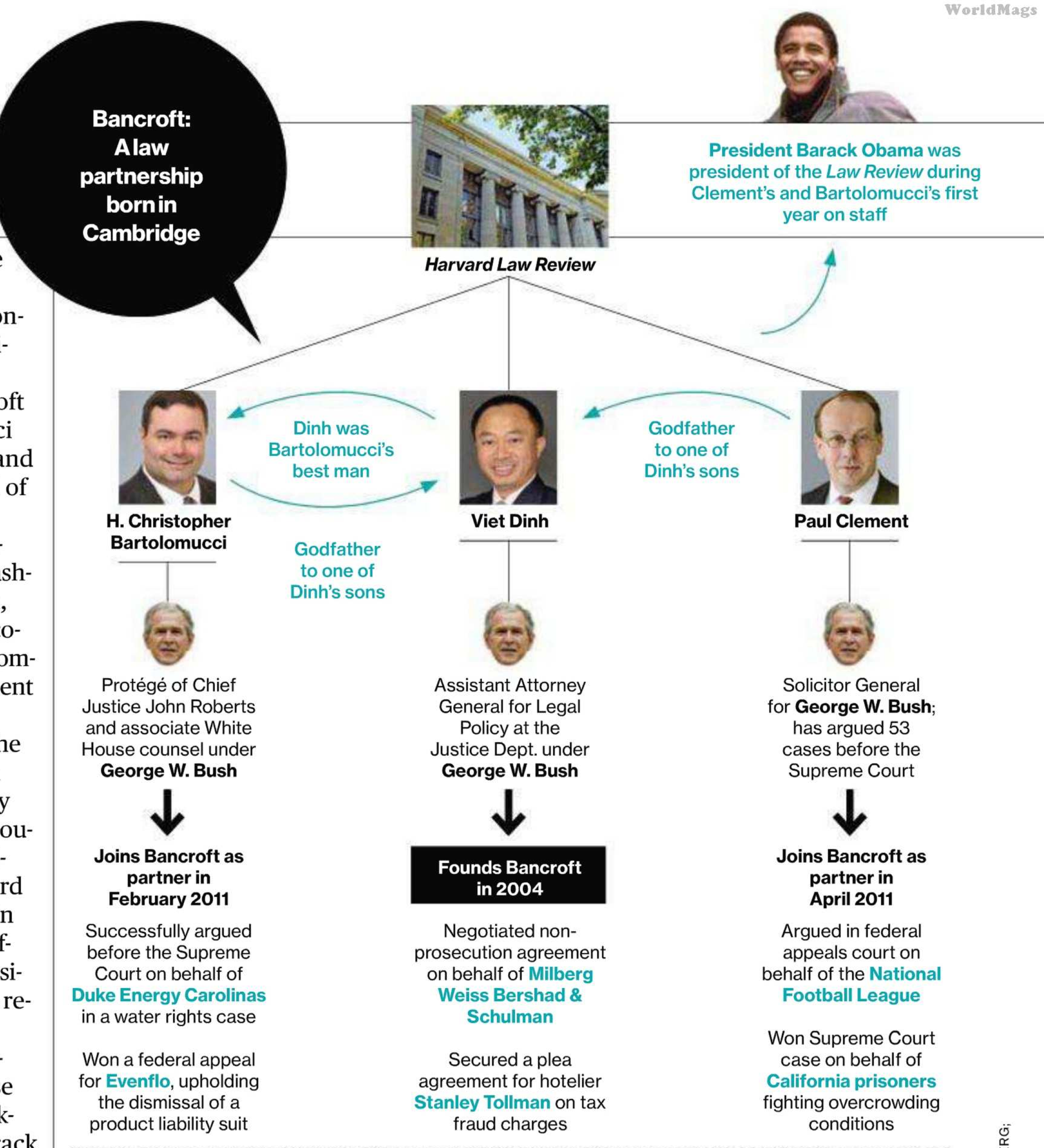
3) If flesh touches the saw, it alters the current; brake activates



4) The blade stops instantly and drops below the tabletop



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according to people with knowledge of the matter. His new colleagues at Bancroft were more amused than concerned about their newfound notoriety. Referring to the protesters who showed up at the firm's door, Bancroft partner H. Christopher Bartolomucci says: "We took their piece of paper and thanked them, and that was the end of the meeting."

Clement's arrival has put tiny Bancroft on the map as a go-to firm in Washington for high-stakes appellate work, whether for conservative causes percolating through the federal courts or complex business cases like the one Clement argued on June 3 before a federal appeals panel in St. Louis on behalf of the **National Football League** owners in its labor dispute. "I would expect they would have the kind of success that boutiques composed of tremendously talented guys tend to have," says Bradford Berenson, a partner at Sidley Austin in Washington. Adds Berenson: "The difficulty is not going to be attracting business, it's going to be having adequate resources" to handle big cases.

Clement, Bartolomucci, and Bancroft founder Viet Dinh became close friends in the early 1990s while working on the *Harvard Law Review*. (Barack Obama was president of the law review during Clement and Bartolomucci's first year at the publication.) The three bonded over long hours checking legal citations, wonky arguments over the Commerce Clause, and late-night dinners of Vietnamese food. "Those are guys who would be successful whatever they would do," says Harvard Law professor Charles Fried, who hired Dinh and Bartolomucci as research assistants when they were students.

Since graduating, each has worked in all three branches of government on matters ranging from judicial nominations to the investigation of President Bill Clinton's Whitewater land deal to counterterrorism policy in the wake of Sept. 11. Clement, 44, was Solicitor General for George W. Bush and has argued 53 cases before the high court, making him one of a handful of appellate specialists in Washington with that much experience. Dinh, 43, who headed the Justice Dept.'s Office of Legal Policy under Bush, is also a full-time professor at Georgetown University Law Center and a board member at **News Corp**. Bartolomucci, 44, was a protégé of Chief Justice John Roberts while in private practice. He went on to serve as associate White House counsel under Bush, vetting U.S. attorneys and handling pardon requests.

While Bartolomucci and Clement argue cases in the federal appellate courts, Dinh's practice consists mainly of advising corporate boards and executives with tough problems on their hands. He got Justice to drop charges against the securities class action firm Milberg Weiss Bershad & Schulman in 2008 in exchange for a $75 million fine. The non-prosecution agreement allowed the firm, now known as Milberg, to keep its doors open after a wide-ranging kickback scandal that sent several of its top partners to prison. Dinh also helped negotiate a 2008 plea deal for Stanley S. Tollman, founder of **The Travel Corporation**, who was fighting U.S. tax fraud charges. More recently, Dinh advised the former chairwoman of the audit committee of **WellCare Health Plans**, who resigned last year after questioning whether the insurer had proper oversight of its accounting. The company disputed her allegations.

Eschewing the tradition of putting his own name on the door, Dinh decided to call his firm Bancroft after a street in Washington's high-rent Kalorama neighborhood, where he once lived. Dinh, Bartolomucci & Clement is "not Anglo enough," jokes Dinh, who was born in Saigon during the Tet Offensive and fled Vietnam in 1978.

Clement hasn't had time to unpack his boxes since landing at Bancroft on Apr. 25. Besides the NFL case, he's handled an appeal on behalf of **SC Johnson** in a retirement benefits case. He also argued in an Atlanta federal appeals court on behalf of 26 states seeking to overturn Obama's health-care law and was just hired by Arizona to petition the Supreme Court to overturn an injunction blocking parts of the state's controversial 2010 immigration law.

His decision to work on the Defense of Marriage Act case has earned Clement respect in the legal community. At

STEVE LISS/TIME & LIFE PICTURES/GETTY IMAGES; DARREN MCCOLLESTER/GETTY IMAGES; ADAM BERRY/BLOOMBERG; OPPOSITE PAGE, PAWLENTY: MICHAEL TERCHA/CHICAGO TRIBUNE/GETTY IMAGES

425,000 (AND COUNTING)
Putting the apps in Apple page 39 ▶

a press conference in April, Attorney General Eric Holder, whom Obama had instructed to stop defending the constitutionality of the 1996 statute, said criticism of Clement was "very misplaced." Clement remains philosophical about the dustup: "It just goes to show: If you really practice law, you can tick off everybody." —*Robert Schmidt*

The bottom line *Three Harvard Law alums with years of government legal work under their belts have reunited at a powerful conservative D.C. law firm.*

Fiscal Policy

Millionaire Taxes Are Falling Out of Vogue

- ▶ **Opposition from Republicans and business are leading to a rollback**
- ▶ **It "just petered out. ... All of these states are backing away now"**

Millionaires can breathe a bit easier. While President Barack Obama says he wants to let income tax cuts that benefit only the wealthiest Americans expire in 2013, several states are rolling back tax increases for top earners.

New York's highest tax rate on incomes exceeding $500,000 will fall back to 7.85 percent, from 8.97 percent, this year. Maryland's 6.25 percent tax on incomes above $1 million expired at the end of 2010, while California's top tax rate for millionaires has dropped to 10.3 percent from 10.55 percent.

At least seven states instituted temporary so-called millionaire taxes during the recession. Those levies are becoming harder to justify now that state revenues are rebounding. Overall, state tax revenue grew 12 percent in April compared with a year earlier, which may trim $20 billion from estimated state budget shortfalls, according to a recent Goldman Sachs report. The soak-the-rich drive "just petered out," says Joseph Henchman, vice-president for legal and state projects at the Tax Foundation in Washington, a group focused on lowering taxes. "All of these states are backing away now."

Business groups have been vocal opponents of the temporary hikes. The Business Council of New York State has opposed efforts to maintain the tax increase on the grounds that such measures are an indirect tax on business income. Most business owners who are paid by partnerships or S corporations report business income on their individual returns. Kenneth J. Pokalsky, the Business Council's senior director of government affairs, says 25 percent of revenue generated from the state's tax on higher earners came from business income. In California, the Silicon Valley Leadership Group, whose members include **Bank of America**, **Apple**, and **Microsoft**, along with 12 other business groups, have told lawmakers that tax increases should be extended only if lawmakers agree to "structural reforms" of the budget.

Republicans, who typically oppose tax hikes, now hold a majority of governorships—29—and many were elected last year after campaigning against tax increases. New Jersey Governor Chris Christie, a Republican, received national attention after vetoing a bill that would have extended a tax on millionaires in the state.

Some Democrats are also fighting the higher taxes. New York Governor Andrew Cuomo sparked a battle with fellow party members in the legislature earlier this year by opposing legislation that would maintain the higher rates on individuals earning more than $1 million. Maryland Governor Martin O'Malley, a Democrat, didn't push to extend his state's millionaire tax last year. "I would like to think it's because these are not very good policies," Henchman says. "If you're a conservative, you don't really like these taxes. If you're a liberal, these [state] services should be so important that everyone should have to pay for them."

The American public is almost evenly divided on the question of whether the wealthy should shoulder a higher tax burden. A Gallup poll released on June 2 found 49 percent of respondents opposed higher taxes on the rich, while 47 percent supported them.

Kim Rueben, director of the state and local program at the Tax Policy Center in Washington, a nonpartisan research organization, says higher tax rates are tough to sustain in states that have progressive tax codes. New York, for instance, has seven tax brackets, with the highest rate kicking in at an annual income of $500,001. "There are certain places that I think can afford to increase the progressivity of their tax system," she says. "In places that have a more progressive system, like California and New York, it becomes harder to keep raising that revenue."

A few states are bucking the national trend. Connecticut has raised its top tax rate from 6.5 percent to 6.7 percent. Oregon voters approved a measure in January establishing two new tax brackets: 10.8 percent for those earning more than $125,000 and 11 percent for those making more than $250,000. District of Columbia Mayor Vincent Gray proposed raising taxes for residents earning more than $200,000, but the District council nixed the plan. Someone making "$200,000 is not a rich person," says Barbara Lang, president of the D.C. Chamber of Commerce. "It's not a lot of money." —*Steven Sloan*

The bottom line *New York, Maryland, and California are knocking down tax rates for high earners, while the District of Columbia has nixed an increase.*

Debated



"The best way, and possibly the only way, to ensure fiscal discipline is to put the Congress in a spending straitjacket. That's why I support a constitutional amendment that not only requires a balanced federal budget but also caps federal spending ... at around the historical average of 18 percent of GDP."

—Tim Pawlenty, GOP Presidential aspirant, in a June 8 speech



"Unfortunately for Pawlenty, his tax plan leaves him about $8.4 trillion short. ... He can either embrace a huge middle-class tax increase or give up his claims to a balanced budget. If he doesn't make up that revenue, deficits and debt will skyrocket ... to levels not seen in half a century."

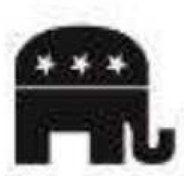
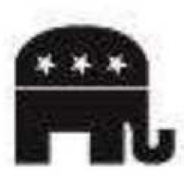
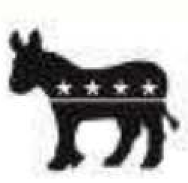
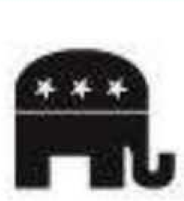
—Michael Linden, Director of Tax and Budget Policy at the Center for American Progress, in a blog post



Ethics

Winging It

New Jersey Governor Chris Christie hit a patch of turbulence earlier this month after using a $12.5 million police helicopter to ferry him to his son's high school baseball game and later to a meeting with Iowa fundraisers eyeing him for a Presidential bid. Critics immediately lit into the first-term Republican, who repeatedly has called for "shared sacrifice" as he struggles to close a yawning budget deficit. As the list below shows, Christie isn't the first governor to overstep his frequent-flier privileges. —*Esmé E. Deprez and Elise Young*

Governor		Party	Modes of Transportation	Outings	Fallout
	**Bob Riley (Ala.)** former		State plane	Attempts by a junior legislator to launch an investigation into whether Riley improperly used state-owned aircraft **to attend weddings of former staff members** dead-ended in 2007.	The ethics complaint didn't get traction because Riley's office had been posting flight logs online.
	**Sarah Palin (Alaska)** former		Commercial jets	Palin sold the jet purchased by her predecessor but caught flak for billing the state for **nine trips by her daughters,** including one to attend a snowmobile race and a jaunt to New York.	Palin reimbursed the state about $7,000 without admitting wrongdoing.
	**Rod Blagojevich (Ill.)** former		State-owned planes	Blagojevich, who refused to relocate from Chicago to the state capital of Springfield, logged nearly 1,000 flights on state-owned aircraft, **often with family and friends in tow,** according to one report.	The flights amount to a peccadillo compared with other allegations of corruption he is fighting.
	**Steve Beshear (Ky.)**		State-owned planes	Beshear in 2008 barred the use of state funds for personal and political travel. Then the press uncovered his trips to some 40 campaign events and **a family outing to an NCAA tournament.**	The Kentucky Democratic Party and Beshear's campaign reimbursed the state about $90,000.
	**Bobby Jindal (La.)**		Leased helicopter	The Gulf Coast wasn't the only thing sullied by the BP spill: Jindal's reputation took a hit because he used **Black Hawks from the Army**, instead of a state chopper, to survey the damage.	BP picked up the $3.9 million tab for the Black Hawks, according to state officials.
	**Jane Swift (Mass.)** former Lt. Governor		State helicopter	Swift made headlines in 1999 when, while serving as lieutenant governor, she commandeered a state chopper so she could fly to her home in western Massachusetts to **tend to her sick child.**	Swift issued a public apology.
	**Haley Barbour (Miss.)**		State jet	Barbour, a frequent flier on the state-owned Cessna, **billed taxpayers $7,020** earlier this year to fly to Washington, where he attended a conference on government overspending.	The incident dented Barbour's reputation as a fiscal conservative.
	**Jim McGreevey (N.J.)** former		State helicopter	McGreevey admitted to 14 instances of traveling on state choppers **for nongovernment business.**	The Democratic State Committee reimbursed New Jersey $18,200 in 2002.
	**Brad Henry (Okla.)** former		State plane	Henry boarded the *Spirit of Oklahoma* in 2009 to **preside at the Florida wedding of two state employees**. Cost to taxpayers: $5,700, not including pilot fees, according to official records.	Bad press.
	**Mark Sanford (S.C.)** former		State plane	Sanford used state aircraft to whisk him to **hair and dental appointments.**	Paid $74,000 in civil fines in 2010 without admitting wrongdoing.
	**Mike Rounds (S.D)** former		State plane	Rounds, a licensed pilot, was at the controls of state aircraft once or twice a week. That cost taxpayers **$723,000** over the past three budget years.	Bad press.
	**Bob McDonnell (Va.)**		State plane	Who would miss their daughter being crowned queen at an **apple blossom festival**? Not McDonnell, who used a state-owned plane to get to the ceremony and **a Nascar race.**	Bad press.

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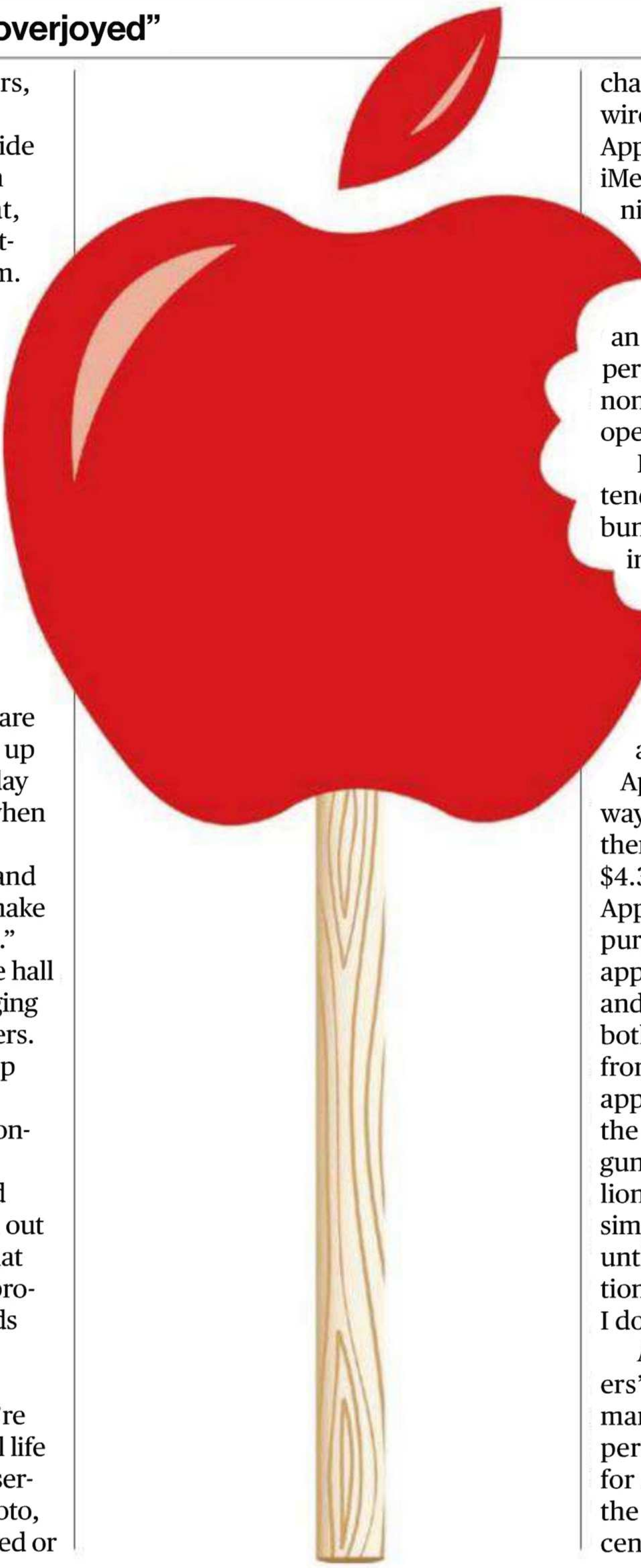
Contents ▶ Next year Intel will finally be inside mobile devices 41 ▶ Actually, tech stocks are cheap 41 ▶ Is Google's Web-centric Chromebook late to the party? 42 ▶ Innovator: Matt MacInnis's interactive iPad textbooks 43 ● Edited by Jim Aley

Technology

How Apple Feeds Its Army of App Makers

▶ Jobs lets them make money, makes easy-to-use tools, and keeps out the riffraff

▶ "People around here are overjoyed"



As he has for each of the past 14 years, Andrew Stone woke at 3:45 on the morning of **Apple**'s annual Worldwide Developers Conference on June 6 in San Francisco, grabbed his yoga mat, and joined the queue of techies waiting to be let in for Steve Jobs's 10 a.m. presentation. The gangly Stone, a former architect who has written software for Jobs's machines since the 1980s, revels in talking tech with fellow Apple geeks, particularly the Europeans and Asians who often save a night's hotel fare by spending the night in line.

This year, more than ever, the good mood was powered by something other than camaraderie: Developers are making money, getting lots of contract work. "You have no idea how many people around here are overjoyed," says Stone, 55, who flew up from his home in Albuquerque the day before. He recalls far leaner years, when many struggled to come up with the $3,000 or so for the conference fee and travel. "Now, good developers can make almost as much money as they want."

The scene outside the conference hall is a snapshot of the war Apple is waging for the hearts and minds of developers. The scale and diversity of Apple's app universe—425,000, roughly twice as many as Android's—is a big reason consumers have purchased more than 200 million iPads, iPhones, and iPod touches. In his WWDC talk, Jobs laid out a post-PC vision of online services that will open up vast opportunities for programmers to come up with new kinds of software. "We're going to demote the PC and the Mac to be just another device," Jobs told the crowd. "We're going to move the hub of your digital life to the cloud." He announced a new service, iCloud, that will ensure any photo, music, or other file that is downloaded or changed on your iPhone is automatically, wirelessly synched to any of your other Apple devices and vice versa. A new iMessage will make it simpler to communicate via text, voice, and video. The basic iOS operating system has been improved, which will make it easier to snap pictures, share files, or find an article. To the extent that Jobs can persuade consumers not to bother with non-Apple products, his pull with developers may increase as well.

Freelance developers such as Stone tend to be an idealistic, egalitarian bunch, suspicious of big companies intent on telling them, or consumers, what to do. And yet Apple has expertly played on their pragmatism—programming tools are slick and simple to use, for example. The main reason there are so many more apps available for Apple products is that there are more ways for developers to make money on them. Consumers have paid more than $4.3 billion for apps sold on Apple's App Store. That includes the original purchase, plus upgrades and ads that appear within the apps. Eddie Marks and his college roommate haven't even bothered to count up the winnings from the ads that appear on their free app, which lets iPhone users simulate the sound of cocking and firing a shotgun. "We've made more than $1 million," says Marks, whose initial goal was simply to raise rent and beer money until he could find a job after graduation in 2008. "It could be $2 million, but I doubt it."

Apple hasn't monopolized developers' attention. According to a survey by market research firm Evans Data, the percentage of developers writing apps for Android (43.5 percent) just passed the share working in iOS (39.7 percent). While Apple dominates a

ILLUSTRATION BY KELLY BLAIR

WorldMags

425,000

Number of apps for Apple devices, twice as many as Android's

certain high-end niche, Android has been adopted by almost every other phone maker and wireless carrier. Throw in the hundreds of millions of devices running BlackBerry, **Microsoft** Windows Phone, or **Nokia**'s Symbian, and "there's very little exclusivity in the mobile development space," says Evans Data Chief Executive Officer Janel Garvin.

To keep its developers engaged and loyal, Apple sweats the small stuff. Developers rave about the quality of the company's "development environment"—the collection of technical specifications, manuals, and programming tools used to write apps. Those for the iPhone are easily written on Macs by developers using many of the same techniques they've employed over the past 30 years to create Mac programs. There's even an iPhone simulator, a piece of software that lets developers see on their Mac screen exactly how their program would operate on the phone. Apple is also renowned for its application programming interfaces, or APIs, which are the sets of instructions that programmers use to take advantage of an operating system's capabilities. While the 5,200 engineers at Jobs's keynote roared in approval at some of the consumer features (e.g., wireless, PC-less synching), some of the loudest huzzahs were for the 1,500 new APIs. That sounds—and is—complicated. And yet, since Apple makes only three mobile products, writing iOS software is simpler than doing so for Android devices, which come in many more flavors, each with its own quirks. Adam Williams, a computer science graduate student at the University of Massachusetts, has earned more than $100,000 from three iPhone apps. He considered writing software for Android, too, but gave up after spending a few weekends dabbling with **Google**'s developer tools. "It seemed like too much work, for a questionable return," he says.

Developers still have a list of complaints. Like technology powers past and present, Apple isn't above taking over software categories created by partners. When Apple Senior Vice-President Scott Forstall showed how the new iOS software could give reminders to pick up milk at a certain time, it spelled big trouble for companies such as **Remember The Milk**. "That groan you heard from the crowd was the sound of companies realizing that they no longer exist," says **Salesforce.com** CEO Marc Benioff, who was on hand at the keynote.

And while Jobs's software ecosystem may seem egalitarian, it's anything but. Big-name software makers such as **Electronic Arts** are assigned dedicated account reps to handle their complaints and are far more likely to be mentioned in a Jobs keynote or an Apple commercial, which all but guarantees millions of downloads. Smaller players wait in frustration to see if Apple's app-approval staff will give their blessing, with almost no means of influencing the decision. After the success of his Shotgun Free app, Eddie Marks and his partner landed a gig creating a promotional app for the sci-fi movie *Mutant Chronicles*. By the time Apple approved it, the film had come and gone from theaters. "It never went live," says Marks. "I think it's because we got started making toy guns. I'm a little bit bitter about it."

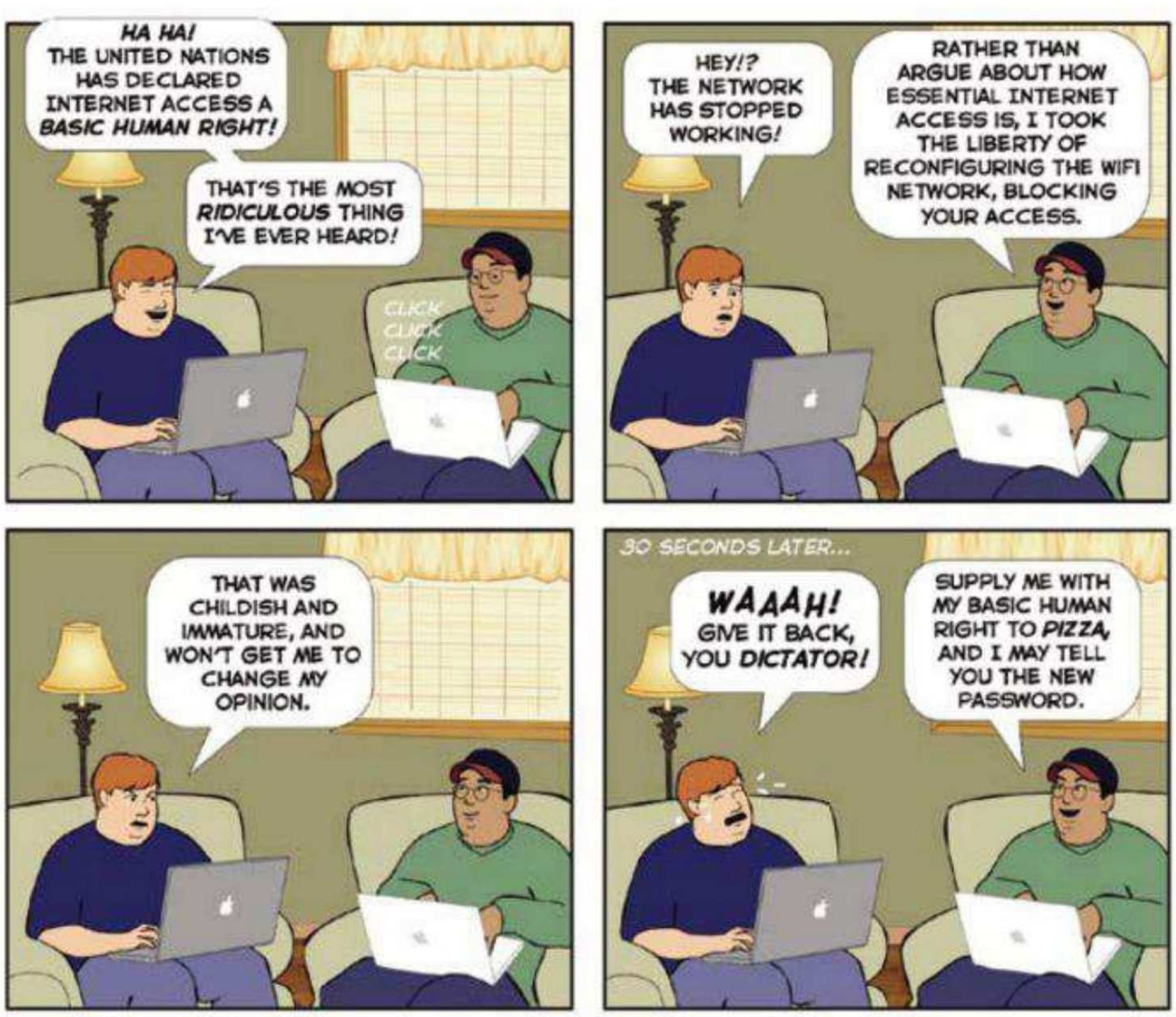
In a way, this subjective system is a strength for Apple: It's quality control. "Their standards are incredibly high. They are not looking for the next copycat, something that has been done before," says Cyriac Roeding, CEO of **Shopkick**, which makes a small device that retailers can deploy to identify iPhone owners when they walk into a store. Rather than just do a PowerPoint pitch for Apple's developer relations staffers, he had to demonstrate that the gizmo actually worked. It did; Shopkick's devices are now in use by **Target**, **Best Buy**, and **Macy's**.

Stone is unwavering in his Apple admiration. Back in Albuquerque, he hosts a weekly gathering of iOS geeks-for-hire at the RB Winning Coffee shop. Stone acts as a kind of foreman, matching coders, database experts, user interface designers, and business guys ("schmoozers," he calls them) to work on the many projects he hears about. "So many companies are throwing themselves into this thing," he says. "It's like the hot new girlfriend."

—Peter Burrows, with Adam Satariano

The bottom line *Apple has expertly cultivated its ecosystem of third-party software developers, a huge advantage in its rivalry with Android.*

The Joy of Tech™

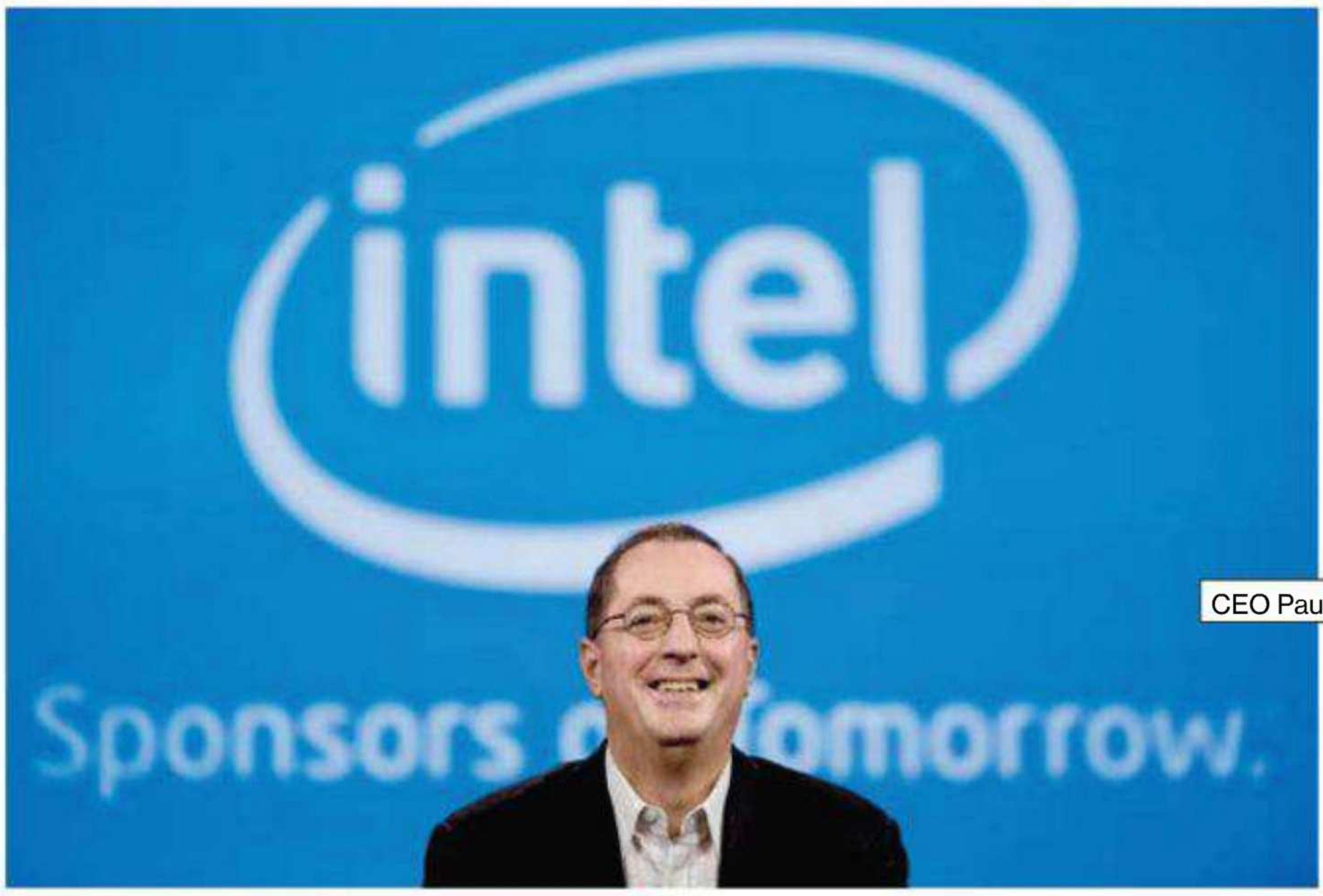


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FROM TOP: BRIAN KILLIGREW/BLOOMBERG; KIM WHITE/BLOOMBERG

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The shrinking financial sector page 45 ▶



CEO Paul Otellini

Chips

Will Intel Finally Crack Smartphones?

▶ Its chips are in servers that power mobile services, just not in handsets

▶ "No guarantee that Intel's products will be competitive in 2014"

Walk into any electronics store around the world and ask for the smartphone or tablet with **Intel** inside, and you'll get a blank look. After more than 10 years and billions of dollars spent developing mobile processors, Intel-powered products are as difficult to find in mobile devices as they are hard to avoid in personal computers—there isn't a single phone on sale that's based on the company's processors.

So when Intel Chief Executive Paul S. Otellini recently asked a roomful of analysts and investors which chip company is raking in the most from the mobile explosion, the room filled with nervous laughter. **Qualcomm? Texas Instruments? Samsung?** Those are the dominant chipmakers for mobile devices—and they all license technology from **ARM Holdings**. It's none of the above, Otellini declared after the tittering died down. The answer? Intel.

His confidence is based on the calculation that for every 600 smartphones or 122 tablets running **Netflix** videos or **Facebook** updates, there's an Intel-powered server in a back office somewhere churning out data. Otellini predicts that the thirst for mobile video, audio, and other content will help push Intel's data-center chip sales to $10 billion this year—about a fifth of projected revenue—and to $20 billion within the next five. Its top-of-the-line Xeon server processors cost as much as $4,616 each, compared with around $15 each for smartphone chips. (Processors for PCs go for $90 on average.)

Impressive as those numbers are, Intel is still missing out on the fastest growing area of computing. In the first quarter of this year, smartphone shipments grew 80 percent to 100 million, according to market researcher IDC. The PC market declined 3.2 percent to 81 million. Intel's problem is that it's still building muscle cars in a world where consumers are buying hybrids. The company has been slow to create a processor cheap and energy-efficient enough to suit mobile devices, which run all day on battery power.

That doesn't mean Intel has given up on mobile chips. It can't. All those smartphones and tablets with ARM-licensed chips are beginning to eat into sales of Intel's largest market, PCs. "If you look three years out, the lines between a smartphone, a tablet, and a notebook PC will become fairly blurry," says Chris Caso, an analyst at Susquehanna International. "The fear is that some of those ARM-based products are going to encroach on the main product line."

After years of delays, the first phones based on Atom chips—Intel's low-power entrant—will start to appear next year, Otellini recently promised. The company won't say who will be manufacturing the handsets. Nomura Securities analyst Romit Shah says he doesn't expect Intel to grab much share before 2013, when its next generation of mobile chips should hit the market.

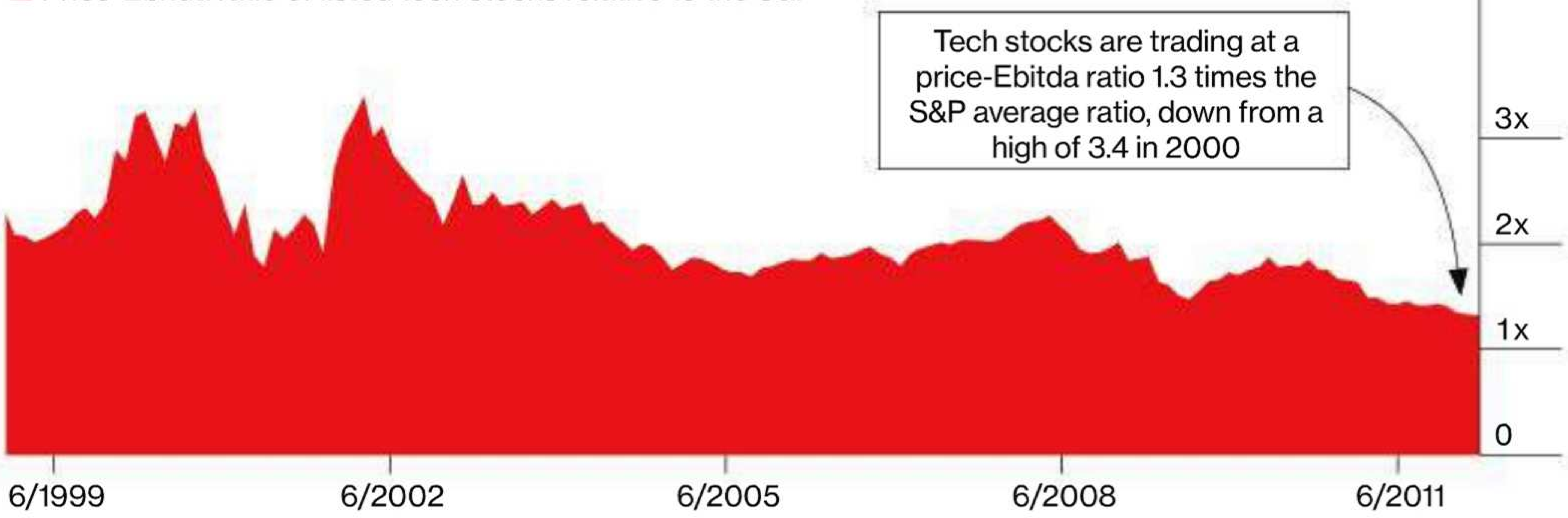
These phone chips of tomorrow will use a technology Intel has been working on for a decade called "3-D tri-gate transistors." According to the company, this approach will allow chips to work a third faster while using less power. "The road map for tri-gates is a possible game changer," says Patrick E. Becker Jr., principal of Portland (Ore.)-based Becker Capital Management, which owns Intel stock. "They will have up to a

Markets

What Bubble? Tech Stocks Are Cheap

With startups like Groupon preparing IPOs, some investors are warning of Bubble 2.0. But public tech companies are trading at their cheapest valuations since 1998. —*Lu Wang and Rita Nazareth*

■ Price-Ebitda ratio of listed tech stocks relative to the S&P



DATA: BLOOMBERG

three-year lead, and it will enable them to reenter the mobile market."

Of course, by the time Intel's next-generation mobile processors make their debut, Qualcomm, TI, Samsung, and all the companies that already make phone and tablet processors will have advanced designs of their own. "While it is good to see Paul Otellini's continued commitment to Intel's success in handsets, there is no guarantee that Intel's products will be competitive in 2014 or even align with the market direction," says Jim McGregor, chief technology strategist for market researcher In-Stat. And while Intel's trying to crack the low end of the market, the ARM camp is taking its first steps in designing chips to compete with Intel on its home turf—PCs and, eventually, servers. —*Ian King*

The bottom line *The mobile boom is powering Intel's server chip business. With PC sales dropping, it needs to enter the smartphone and tablet market.*

Laptops

And Now, Google's Other Operating System

▶ The long-delayed Chrome-powered netbooks hit stores on June 15

▶ "The Chromebooks are more of a concept," says an analyst

Google's executives have long enjoyed ribbing **Microsoft** as bloated, slow, and out of touch with computer trends. So there must be a few smirks at Microsoft's headquarters: Google's first, long-delayed Chromebooks are about to arrive in a world that's moved on without them.

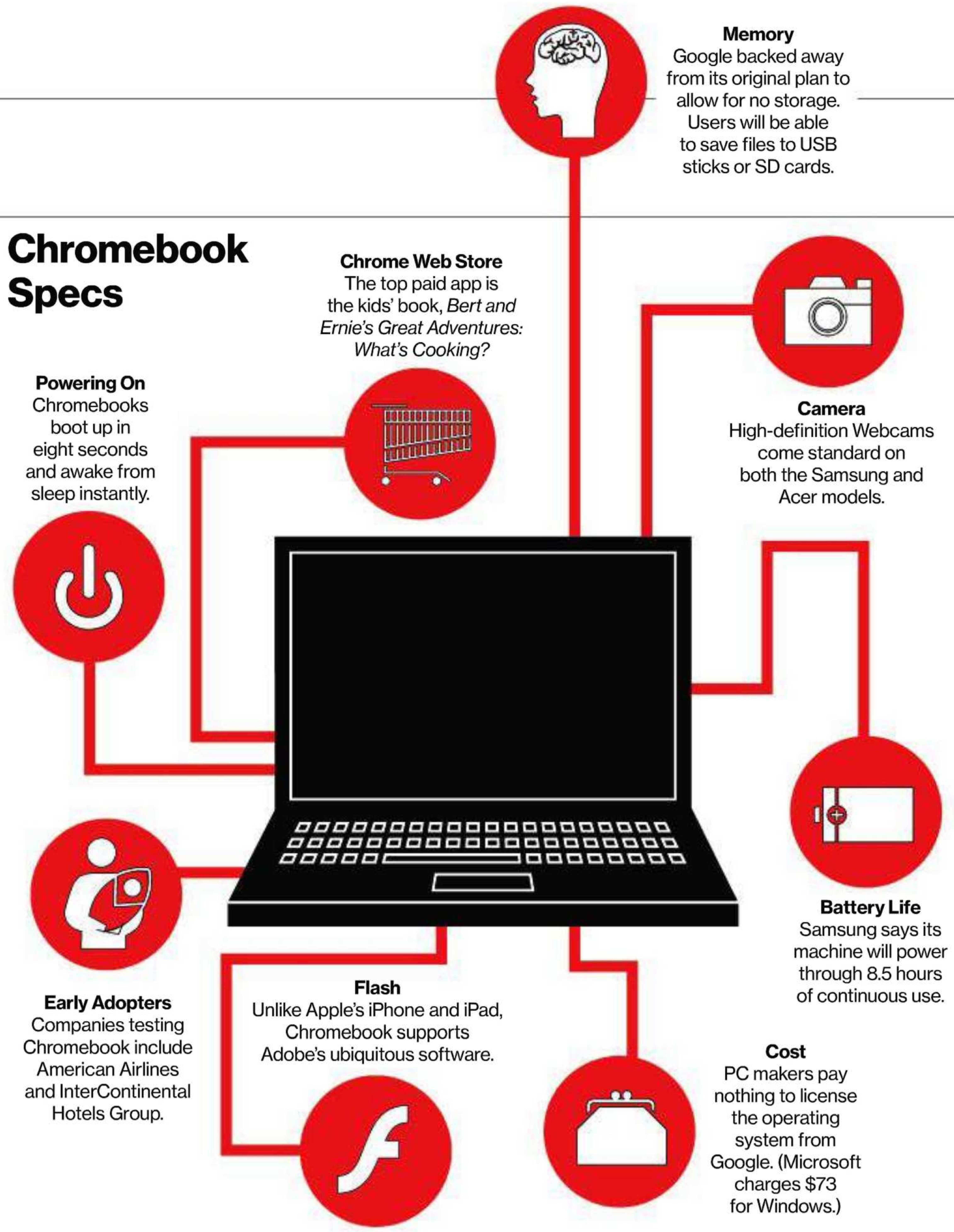
Google laid out its Chromebook vision two years ago: a new type of laptop that revolved around the Web. It would run on a stripped-down operating system known as Chrome—imagine a Web browser that isn't on your computer's desktop, it *is* your computer's desktop. Chromebooks would turn on in seconds and would let users flit around the Web and store things such as photos and documents via Flickr, Dropbox, and other online services. The idea was to wean people away from storing files directly on their computers and managing files and applications on the desktop screen so familiar to anyone who's used a PC or a Mac. The cloud had arrived and deserved its own computer.

The initial batch of Chromebooks, which are shipping on June 15, lives up to that vision. These machines start up fast (eight seconds). Once people log in with their Google credentials—the same used for Gmail—they arrive at a home page on the Chrome Web browser and off they go. That's the gist of the Chromebook experience.

Samsung and **Acer** have built the first models, which will sell for about $430 for Wi-Fi-only systems and $500 for versions that can also connect to **Verizon**'s 3G wireless network. (As with its mobile operating system, Android, Google doesn't charge a licensing fee for Chrome.) Consumers in the U.S. can buy them through **Amazon.com** and **BestBuy.com**; Europeans will be able to get them in the coming months. Google also has a monthly subscription program for businesses and schools, leasing Chromebooks for $28 per employee and $20 per student.

Like smartphone sellers, Google has created an online app store for Chrome—both for Chromebooks and

Chromebook Specs



Quoted



"Groupon is going to be wildly profitable."
—Eric Lefkofsky, Groupon's chairman. The daily deal company, which plans an initial public offering, has lost $540 million since its founding in 2008

FROM TOP: TIMOTHY ARCHIBALD FOR BLOOMBERG BUSINESSWEEK; SALLY RYAN/THE NEW YORK TIMES/REDUX

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Chrome browsers on regular PCs. Users won't see familiar desktop software like TurboTax, Photoshop, or Microsoft Office, but they'll be able to get H&R Block At Home, BeFunky Photo Editor, and Google Docs.

On a Chromebook, you need to be online to run any of these applications. "That really is the big problem," says Tim Bajarin, president of analyst firm Creative Strategies. "The reality is that you're not always going to be in a place where you're connected." Later this summer, Google plans to offer versions of Gmail and Google Calendar that will work on a Chromebook even when it's offline. The company will also help developers similarly adjust their apps, says Google spokesperson Lily Lin.

Google has decided to add more traditional file management tools as well. For example, users will be able to open and save music, photos, and other files on SD cards and USB sticks, just not on the laptops' hard drives.

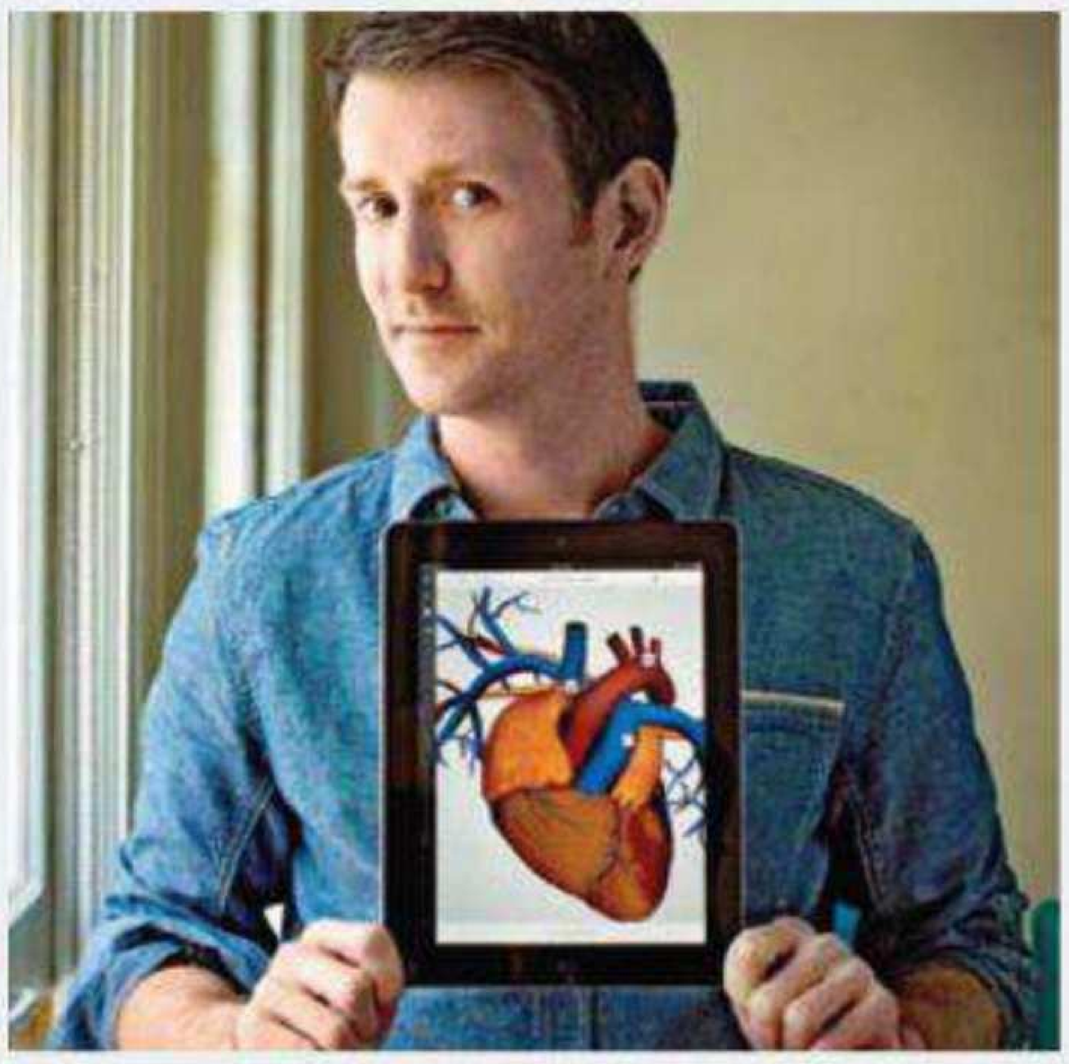
Google once planned to ship the Chromebooks in 2010. They would have seemed like a breath of fresh air then. Over the past year, though, tablets and smartphones have continued to surge. These devices deliver the same basic experience as the Chromebooks since they too tend to revolve around the Web. But there's more device variety in the tablet and smartphone markets, and they tend to have livelier app stores, including Google's own Android marketplace.

In the past couple of weeks, Microsoft and **Apple** have shown off revamped versions of their computing operating systems. Microsoft's Windows 8 (due next year) has a radical interface that resembles its smartphone software and is integrated with **Facebook** and other Web services. Apple's new Lion version of OS X will link to iPhones and iPads through cloud-based services. Both these operating systems will provide access to the cloud without the big tradeoffs of Chrome, says IDC analyst Al Hilwa. "It seems to me that the Chromebooks are more of a concept," he says. "Google is trying to showcase an ideal of what life might be like if everything depended on the cloud." —*Ashlee Vance*

The bottom line *Google's simple, inexpensive Chromebook showcases cloud computing—but may be too stripped-down, and late, to go mainstream.*

Innovator

Textbook 2.0



Matt MacInnis spent eight years at Apple focused on education projects. Now his San Francisco startup, Inkling, is building interactive textbooks for the iPad

Many college science students lug around *Brooker Biology*, a 1,438-page tome published by McGraw-Hill that costs up to $150 and weighs close to five pounds. This fall they'll have a new option: *Brooker Biology* for iPad, a touchscreen textbook that runs on Apple's svelte tablet computer.

It's one of dozens of digital textbooks created by Inkling, a two-year-old San Francisco company founded by Matt MacInnis. Although some digital textbooks already exist—CourseSmart, a joint venture between major publishing companies, has a fairly comprehensive selection—most are basically scanned copies of print products. Inkling's offerings are more interactive. In its *Brooker Biology*, a 3D diagram of the human heart can be rotated with the flick of a finger, complicated processes such as cell co-transport are explained with videos, and dynamic quizzes reinforce lessons. It's social, too: Students can connect with one another to share marginalia or passages they've highlighted. The book's 60 chapters can be bought individually for $3 apiece, so professors can assign just the sections they want to teach.

Inkling expects to have 100 iPad titles ready by fall. This year's crop of 108 first-year students at Warren Alpert Medical School of Brown University will be required to buy iPads and use Inkling e-books for their anatomy and clinical medicine classes. "This ability to have it be interactive and test yourself is unbelievable," says Luba Dumenco, a course director at the school.

Digital textbooks will "have an appreciable impact on how well we educate the next generation of learners," says MacInnis, 31, who founded Inkling in 2009 after an eight-year gig running various education initiatives at Apple. He's assembled a team of more than 50 programmers and pedagogy experts and partnered with some of the country's largest textbook publishers. Two of them, McGraw-Hill and Pearson, invested millions in Inkling earlier this year. On each sale, Inkling shares the revenue with the publisher of the book.

Inkling has built software that speeds up the process of turning a print textbook into a digital one, says MacInnis, a Nova Scotia native and Harvard grad. "A 1,400-page textbook is way more complex than most people care to notice," he says. "We turn it into a formula." Inkling's computers scan through files provided by the publisher and automatically arrange text, images, and audiovisual elements in an intuitive interface.

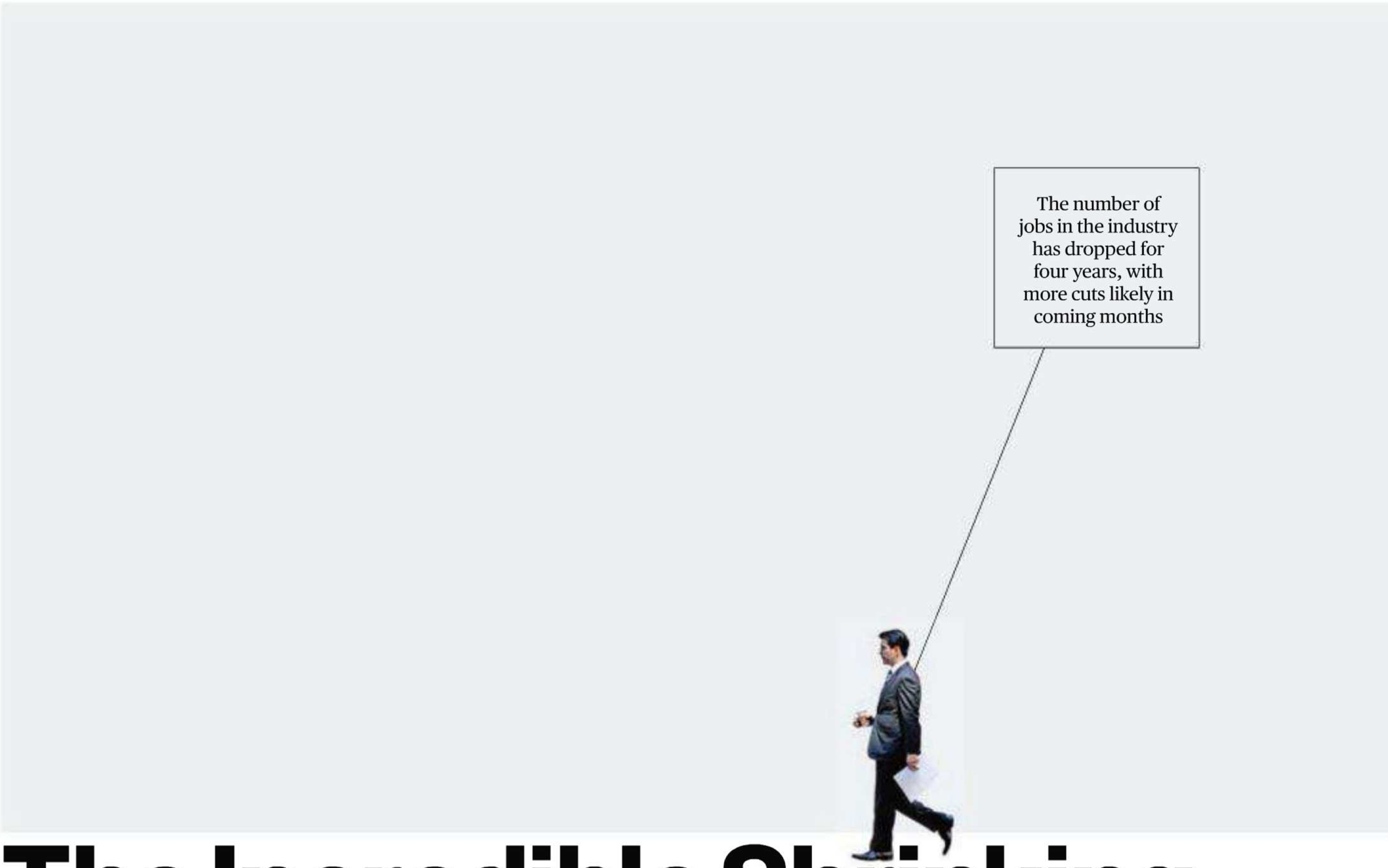
MacInnis says digital textbooks are a new and welcome source of income for educational publishers worried about the expansion of the secondhand market, especially online book rental sites such as Chegg. "That future is scary," he says. "This future is actually welcoming and exciting." Ⓑ
—*Douglas MacMillan*

Background ▶ The Harvard grad spent eight years at Apple
Technology ▶ Interactive, feature-rich textbooks for the tablet era
Response ▶ Inkling is required for new med students at Brown


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DANIEL ACKER/BLOOMBERG

The Incredible Shrinking Financial Sector

▶ **The sluggish economy and a host of new rules limit revenue and profit**

▶ **"It's much more about carving up the pie ... rather than growing the pie"**

Financial firms are becoming a smaller part of the U.S. economy as they deal with a past that won't go away and a future of lower revenue and fewer jobs. Persistent low interest rates and stagnant loan growth are shrinking interest income just as new regulations are putting a lid on the fees banks charge their retail customers. Net revenue at the six largest U.S. lenders—**Bank of America**, **JPMorgan Chase**, **Citigroup**, **Wells Fargo**, **Goldman Sachs**, and **Morgan Stanley**—will probably fall 3.7 percent in the second quarter, the fourth year-over-year decline in five quarters, according to 100 analyst estimates compiled by Bloomberg. Regulations requiring banks to hold more capital as a cushion against losses are likely to crimp profitability. "You don't have to be a scientist to figure out that tighter regulation and more onerous capital rules without economic growth will shrink the industry," says John Garvey, head of the financial industry advisory practice at PricewaterhouseCoopers. Financial companies accounted for 29.3 percent of U.S. corporate profits over the 12 months ended Mar. 31, well off the record high of 41.7 percent set in the 12 months ended Sept. 30, 2002.

Investors don't like what they see. Financial stocks have trailed the broader market for 9 of the last 11 months. The ratio of the price of the Standard & Poor's 500 financials index to the S&P 500-stock index is less than 0.16, down from a peak of 0.36 in March 2004. The only other time in the last 20 years the ratio dropped below 0.16 was a stretch from January to April 2009, when some banks faced nationalization after taking billions in rescue funds to survive the credit crisis. Bank of America, the biggest U.S. lender by assets, saw its stock hit a two-year low on June 6.

Analysts including Meredith Whitney and Nomura Holdings' Glenn Schorr expect the slow growth to result in job cuts on Wall Street in the coming months. The number of U.S. financial-industry jobs dropped for the fourth straight year to an average of 7.63 million in 2010, according to the Bureau of Labor Statistics. That's 8.4 percent below the 2006 peak, and the figure fell to 7.61 million in May.

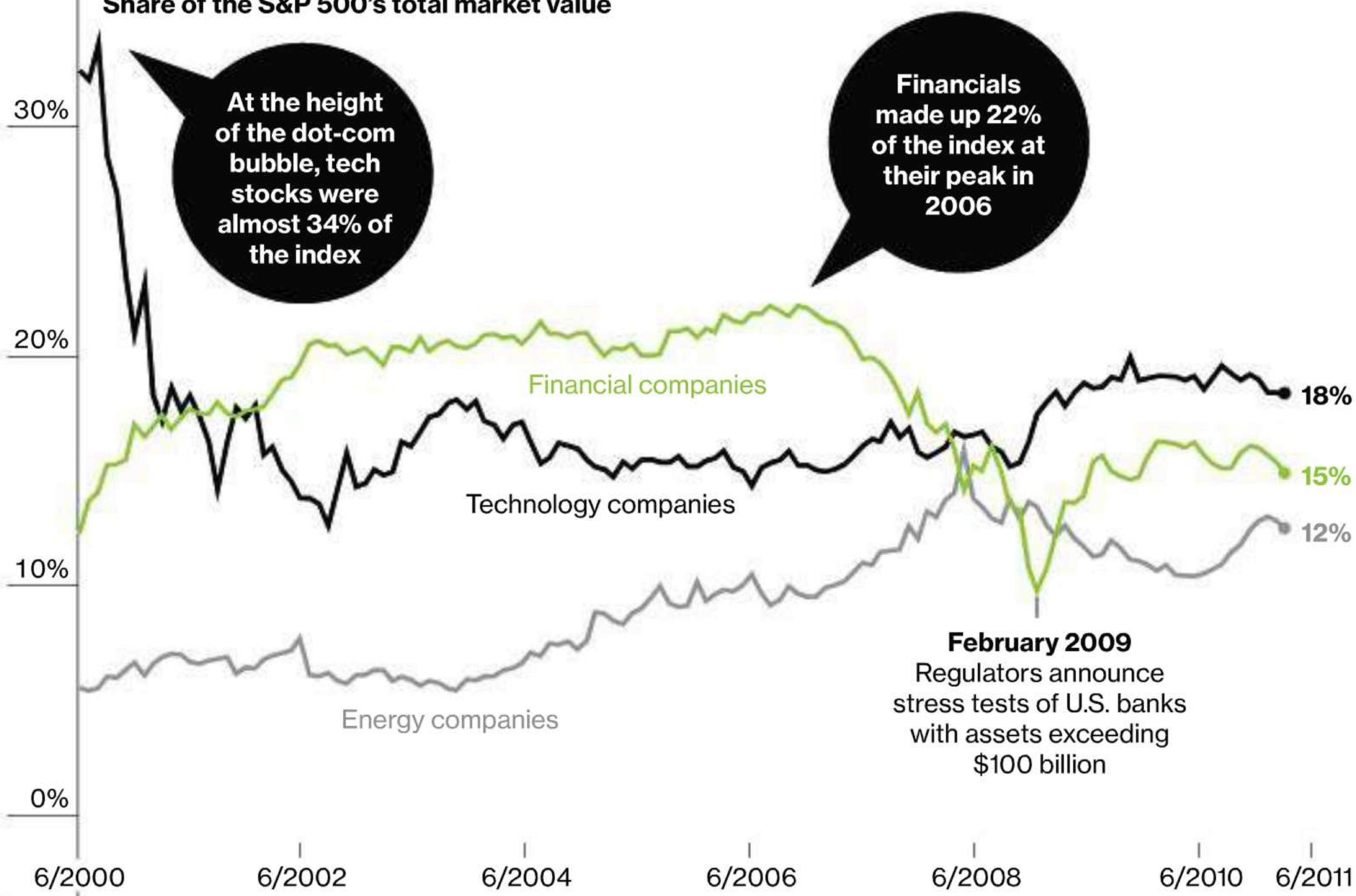
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The mission makes the man? page 58 ▶

Signs of the Banking Industry's Decline

Share of the S&P 500's total market value



Average interest rate earned on loans at the four biggest banks		Change in average loans at the 37 biggest banks by market value, Q1 2010 to Q1 2011	Number of financial industry jobs in the U.S.	
2005	2010		2006	May 2011
7.2%	**6%**	**-4%**	**8.4m**	**7.6m**

DATA: BLOOMBERG; BUREAU OF LABOR STATISTICS; FEDERAL RESERVE BANK OF ST. LOUIS; KBW

Banks face at least 15 major "overhangs" to performance over the next few years, FBR Capital Markets analysts wrote in a June 3 note to investors. Among the factors cited were new limitations on proprietary trading and debit-card swipe fees; state and federal investigations into mortgage practices; and stricter capital and liquidity requirements. New rules set by the Basel Committee on Banking Supervision, which will begin to take effect in 2013, may trim the return on equity of U.S. banks by 3 percentage points, according to estimates by McKinsey consultants. "Those are pretty big clouds, there's no arguing with that," JPMorgan Chief Executive Officer Jamie Dimon said at an investor conference in New York on June 2. At a bank conference in Atlanta on June 7, Dimon asked Federal Reserve Chairman Ben S. Bernanke whether new bank regulations have gone too far. Bernanke answered that it's probably going to take a bit of time before regulators "figure out where the cost exceeds the benefits."

In an effort to boost revenue, banks are shifting their focus back to bread-and-butter businesses, such as retail banking, brokerage services, and asset management. They are dusting off a once-favored strategy, cross-selling–persuading existing customers to buy additional products. Morgan Stanley has hired more than 170 private bankers to make loans and offer deposit products to its retail brokerage clients. Bank of America is looking to win banking business from the two-thirds of its Merrill Lynch customers who have bank accounts with other lenders. Wells Fargo is building its retail brokerage so that it can capture business from 5.2 million clients who hold $1.7 trillion in investment assets at other firms. Says PricewaterhouseCoopers' Garvey: "Right now in the U.S., it's much more about carving up the pie a different way rather than growing the pie."

The country's biggest banks are looking for growth overseas, particularly in emerging markets. Citigroup CEO Vikram Pandit said at a Mar. 9 conference that the bank now gets more than half of its profit from emerging markets. "We have a unique footprint that we believe will allow us to harness global growth trends and deliver value to our client and shareholders over time," says Shannon Bell, a Citigroup spokeswoman. Spokesmen for the other five banks declined to comment or didn't return calls.

Bank of America CEO Brian Moynihan said in February that his bank would try to produce revenue increases that outpaced the growth of the U.S. economy by 1 percentage point, driven by its international operations. Goldman Sachs Chief Operating Officer Gary Cohn said this month that his firm's hiring efforts are concentrated on China, India, and Brazil.

The banks will face political obstacles and strong local competition, while earning lower fees than they command in the U.S. "We expect to continue to see ferocious competition in these markets," analysts from Oliver Wyman and Morgan Stanley said in a March research paper. "Rising costs and falling yields will mean less of the top-line growth comes through to the bottom line."
—*Michael J. Moore*

The bottom line *Banks have seen revenue fall in three of the past four quarters. Many hope that cross-selling and overseas growth can help right the ship.*

Investing

Seeing Beyond the Stock Market Slump

▶ **Money managers remain bullish despite the Dow's five-week drop**

▶ **"In this environment ... dividend-paying stocks" make sense**

The Dow Jones industrial average dropped for five straight weeks through June 3, with one disappointing economic report after another. That's the longest streak of declines for the Dow in seven years. Still, the grim news is doing little to reduce bullishness among U.S. money managers and market strategists, including

Outlook 1

"There's ample valuation support for the market." Investors should consider technology stocks and avoid companies that depend on discretionary consumer spending.
—Liz Ann Sonders, Charles Schwab



JPMorgan Chase's David Kelly and Liz Ann Sonders of **Charles Schwab**, who say strong profit growth and valuations that are below the historic average will lift equities this year.

"The economy is still growing, albeit at a slow pace, and sufficient for corporate revenues, corporate earnings, and corporate cash flow to advance," says Bob Doll, who helps oversee $3.65 trillion at **BlackRock**, the world's biggest money manager. "We're at the end of the recovery and the beginning of the expansion. That's typically a time when stocks still go up, just at a lesser pace."

The Standard & Poor's 500-stock index, which climbed to an almost three-year high of 1,363.61 on Apr. 29, dropped 5.8 percent, to 1,284.94, on June 7. Forecasters have cut projections for U.S. gross domestic product growth in 2011 to 2.7 percent, from 3.2 percent, in March, the biggest reduction in a forecast since the start of the bull market, according to Bloomberg data. "The U.S. economy is in a slowdown, which is more than technical, but still a good deal less than fatal," says Kelly, who helps oversee $445 billion as chief market strategist for **J.P. Morgan Funds**. "The expansion will continue. The economy will actually strengthen in the second half of this year. But given the downpour of bad economic news, it's not surprising the equity markets have taken a hit."

At its June 7 level, the S&P had a price-to-earnings ratio of 14.6 based on the past 12 months' profit, compared with an average of 18 over the past 10 years. Many strategists see that as a positive sign. "There's ample valuation support for the market," says Sonders, who recommends investors buy technology shares and avoid companies that depend on consumer spending. She says the factors that have hampered economic growth this year, such as the effects of Japan's earthquake in March, the European debt crisis, and the spike in commodity prices, are temporary and the economy will continue to improve.

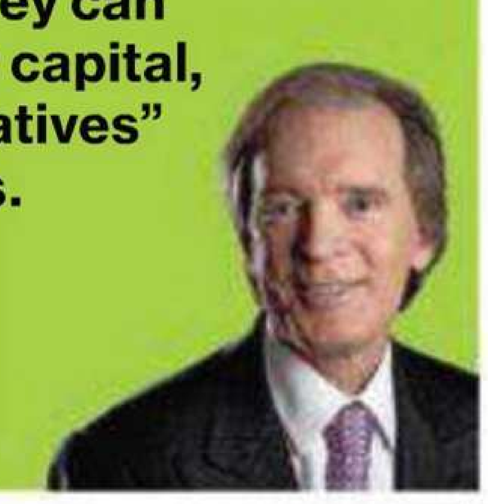
"I think stocks head higher," says Jeff Rottinghaus, manager of the **T. Rowe Price U.S. Large-Cap Core Fund.** He doesn't expect analysts to cut earnings estimates. He especially likes big industrials, which "did more to restructure their businesses in the downturn than any other industry," he says. "They're coming out of the downturn with higher returns and higher margins." His favorites include **United Technologies**, **Honeywell International**, and **FedEx**.

"We're buyers," says Cliff Remily, who co-manages the $9.2 billion **Thornburg Investment Income Builder Fund**. "In this environment, where you have low interest rates, high uncertainty, and a lot of volatility, dividend-paying stocks are an attractive investment." He cites **Coca-Cola**, **McDonald's**, **Kraft Foods**, and **Verizon Communications** as strong choices.

Pacific Investment Management's Bill Gross, who manages the $243 billion **Total Return Fund,** is also a dividend fan. With interest rates near record lows, investors should avoid government debt and buy shares of "conservative" companies such as **Procter & Gamble**, **Merck**, and utilities, according to Gross. While dividend-paying stocks are not as safe as government bonds, they offer potentially higher returns. For investors who "can risk a little bit of their capital, then there are alternatives," he said on June 3. "You have to take a little bit of a chance to avoid getting your pocket picked here."
—*Inyoung Hwang, Nikolaj Gammeltoft, and Rita Nazareth*

Outlook 2

Savers should avoid government debt and consider buying stocks in "conservative" dividend-paying companies such as Procter & Gamble and Merck. "To the extent that they can risk a little bit of their capital, then there are alternatives" to low-yielding bonds.
—Bill Gross, Pacific Investment Management



Outlook 3

"The economy will actually strengthen in the second half of this year. But given the downpour of bad economic news, it's not surprising the equity markets have taken a hit." —David Kelly, J.P. Morgan Funds



The bottom line *Money managers see the stock rally continuing after an almost 6 percent pullback spurred by a series of bad economic reports.*

ROMNEY: BRANDON BIRD; GROSS: SCOTT EELLS/BLOOMBERG

Mortgages

Goldman Closes the Door on Subprime

▶ The sale of a mortgage servicer marks the end of a misadventure

▶ "They bought it at a time when the business was easier"

When **Goldman Sachs** bought **Litton Loan Servicing**, a firm that collects mortgage payments from homeowners, in 2007 for an unannounced price, it seemed like a simple way to get an on-the-ground view of the subprime market. The insight would help Goldman Sachs figure out how much to pay for loans, and Litton would work with borrowers to get them back on track. Other sophisticated investors, including billionaire Wilbur L. Ross and private equity firm **Centerbridge Capital Partners**, bought mortgage servicers with a similar strategy in mind.

It didn't work out as planned. While there were plenty of distressed mortgages and lots of eager

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buyers, the loan holders had little incentive to mark down prices because that would mean taking a big loss on their books. "The distressed-asset market never got as hot as people were hoping it would," says Dean H. DeMeritte, an executive vice-president at Phoenix Capital, a Denver brokerage for mortgage servicing contracts.

On June 6, Goldman Sachs agreed to sell Litton to another mortgage servicer, **Ocwen Financial**, for $263.7 million. The sale comes two months after Goldman Sachs wrote down the value of the business by about $200 million. "It really makes sense for them to sell it," says David B. Hilder, an analyst at Susquehanna Financial Group. "They bought it at a time when the business was easier, and it looked like there might be some insights to be gained in the mortgage market from having a servicer." Neither Goldman Sachs nor Litton would comment.

Founded in 1988 by Larry B. Litton Sr. in Houston, Litton was one of the first mortgage servicers to specialize in working with troubled loans, sometimes called "scratch and dent" servicing. It developed that skill during the savings and loan crisis, when it was hired by **Resolution Trust Corp.** to handle mortgages that were orphaned by failed banks.

Larry Litton Jr., who now runs the company, is known in the industry for his Texas drawl, straight talk, and vocal support for working with struggling borrowers before they get too far behind. Bruce A. Gottschall, the founder of Neighborhood Housing Services of Chicago, a nonprofit that worked with Litton a decade ago, says the company "seemed to me a little bit more flexible in terms of modifications early on." Litton Jr. currently is a member of the Federal Reserve's Consumer Advisory Council, where he has been vocal about foreclosure prevention. Ocwen would not comment on whether he will stay with the company after the sale.

Litton's business grew with the subprime market. In 1995 it serviced $1.2 billion in loans, according to Fitch Ratings. By 2007 its portfolio had ballooned to almost $54 billion; it's about $41.2 billion today. As the boom gave way to the bust, Litton was forced to hire more staff to deal with rising defaults. The company became the target of class actions alleging excessive fees and violations of consumer-protection laws as well as investigations by state and federal regulators. It has agreed to settle at least one of the lawsuits while denying liability; others are pending. It says it is cooperating with government investigations. Goldman Sachs will remain liable for fines and penalties that could be imposed by government authorities relating to Litton's foreclosure and servicing practices before the deal closes.

With the Litton sale, Goldman Sachs will no longer deal directly with homeowners. Gottschall says Goldman's unloading the mortgage servicer is part of a bigger trend: "Wall Street is probably trying to distance themselves from the problems they caused."

—Karen Weise and Christine Harper

The bottom line *By selling Litton Loan Servicing, Goldman Sachs is out of the messy business of working with distressed homeowners.*

Hedge Funds

Cash Keeps Flowing To Cohen's SAC

▶ Scrutiny by prosecutors hasn't deterred clients

▶ "Their investors are voting with their dollars"

Investors have put $250 million into the main hedge fund of Steven A. Cohen's **SAC Capital Advisors** this year, even as prosecutors investigate accounts tied to two former portfolio managers who pleaded guilty to insider trading, according to two people with knowledge of the matter. The fund has attracted a net $1.5 billion since mid-2010. The new commitments don't include money put in by Cohen and employees of the $14 billion firm, say the two people. The fund has gained 9 percent this year through May.

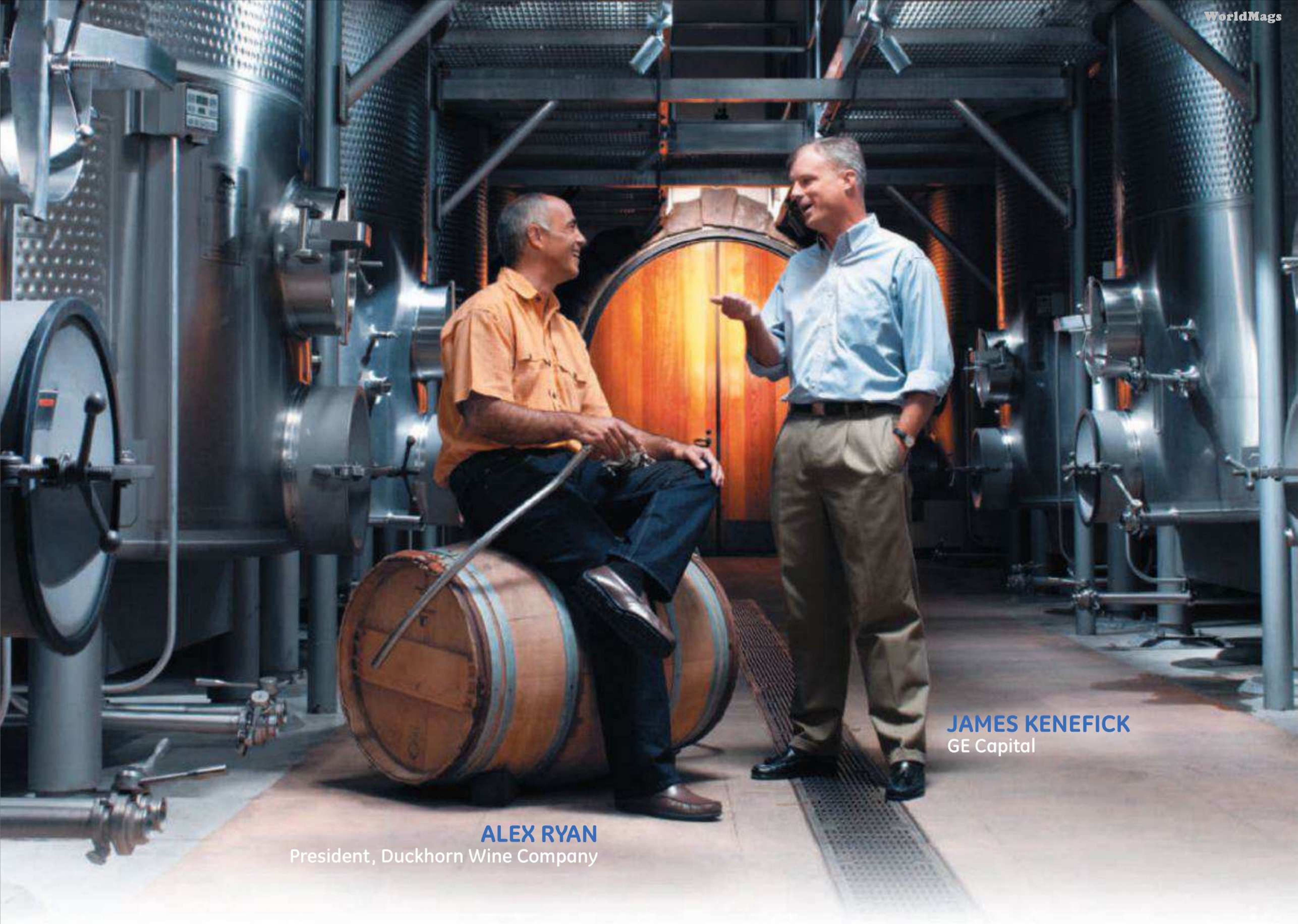


Cohen

MARC STAMAS/WIREIMAGE/GETTY IMAGES

"Their investors are voting with their dollars that they have confidence in SAC's compliance procedures," says Donald A. Steinbrugge, managing partner of Agecroft Partners, a firm based in Richmond, Va., that advises hedge funds and investors. A

WorldMags



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spokesman for Stamford (Conn.)-based SAC, Jonathan Gasthalter, declined to comment.

At other funds, government scrutiny has led to large redemptions or closures. In November, FBI agents from New York and Boston raided the offices of **Level Global Investors** and **Diamondback Capital Management**, firms founded by SAC alumni. Agents also searched the offices of **Loch Capital Management** in Boston and New York-based **Barai Capital Management**. Diamondback investors have pulled more than $1 billion, or almost a quarter of the firm's assets, since the raid. The other firms have closed. Barai Capital founder Samir Barai pleaded guilty on May 28 to securities fraud and other charges.

U.S. prosecutors are investigating accounts at SAC tied to Noah Freeman and Donald Longueuil, former portfolio managers who pleaded guilty earlier this year to federal insider-trading allegations. Longueuil worked at SAC from July 2008 to July 2010, Freeman from June 2008 to January 2010. SAC has said both were fired for poor performance. The investigation is part of an insider-trading probe that has ensnared hedge funds, corporate executives, and so-called expert network firms. No allegations of wrongdoing by SAC or Cohen have been made.

In a Mar. 24 letter filed in Manhattan federal court, prosecutors said they had recovered records from SAC and listed documents tied to the "Cohen Account" that they made available to defense lawyers. The Cohen Account, a portfolio managed by Cohen, uses the best trading ideas unearthed by the 100 teams at SAC. Portfolio managers and analysts submit their stock picks to Cohen and his team. If Cohen uses them in his account, and they make money, the traders get paid for their ideas.

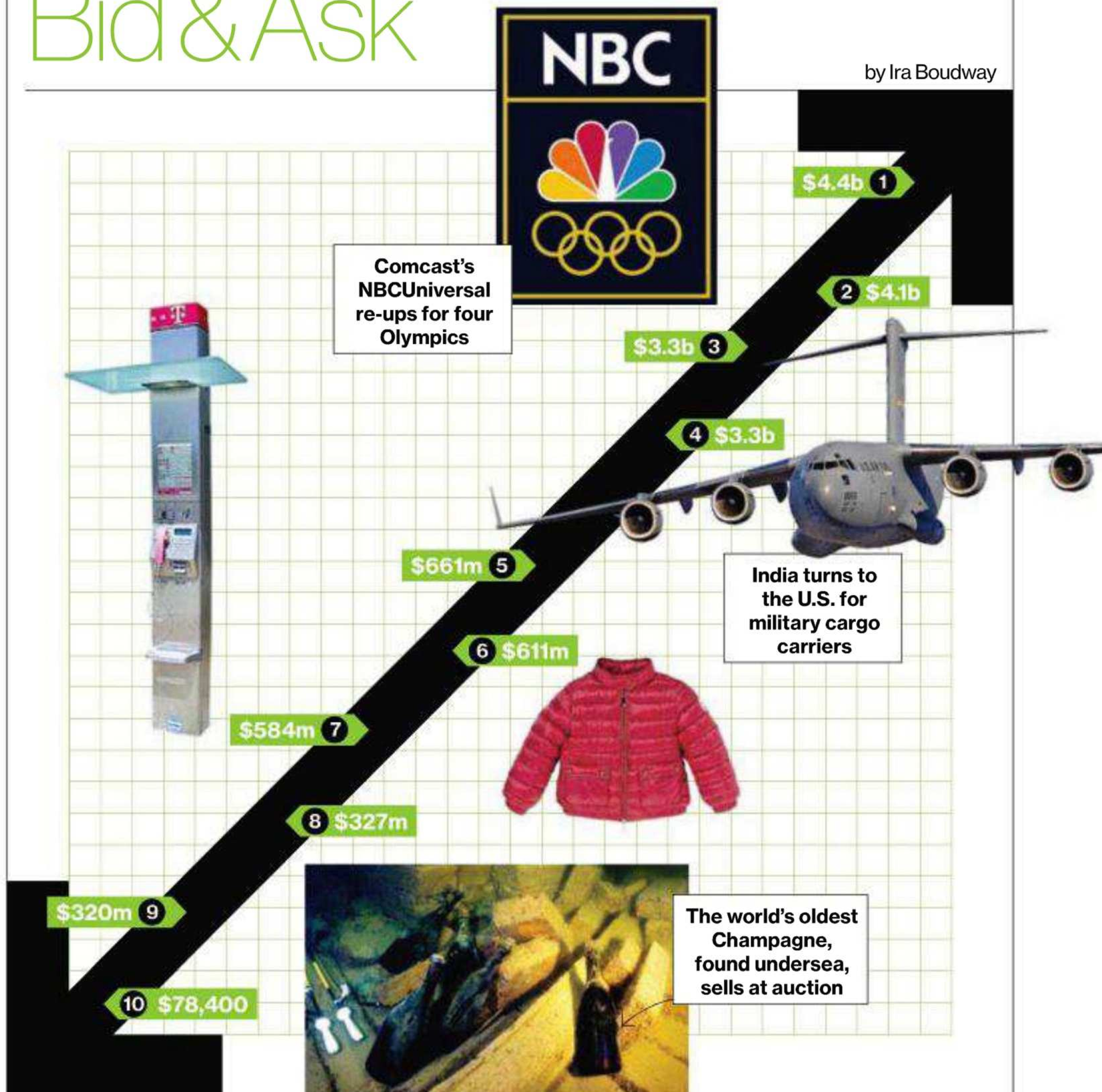
Cohen told clients in May that SAC is considering closing its main fund to new investments. Cohen, who has averaged annual gains of 30 percent, kept the fund closed for its first 13 years. SAC plans to open a fund specializing in quantitative trading in the third quarter—its first new fund in six years, according to two people familiar with the decision. B

—Katherine Burton and Kelly Bit

The bottom line *Cohen's flagship hedge fund has pulled in $250 million this year despite attracting scrutiny amid a broad insider-trading investigation.*

Bid & Ask

by Ira Boudway



1 **NBCUniversal** will pay $4.4 billion to keep the U.S. television rights to broadcast the Olympic Games. The Comcast-owned company outbid Disney's ESPN and News Corp.'s Fox for the four games from 2014 to 2020.

2 India approved buying 10 **Boeing** C-17 military cargo aircraft for $4.1 billion, its largest-ever defense deal with the U.S.

3 Corrugated packaging maker Temple-Inland rejected a $3.3 billion hostile bid by **International Paper**. The company says it will offer shareholders discounted stock to block the offer.

4 Norway's **Statoil** is selling a 24 percent stake in its Gassled gas pipeline network for $3.3 billion. The buyer is a holding company owned in part by Allianz and the Canada Pension Plan.

5 **Vanguard Health Systems**, the hospital operator controlled by Blackstone Group, plans to raise as much as $661 million in an initial public offering.

6 Italian ski-wear maker **Moncler** canceled its IPO, instead selling a 45 percent stake to the Paris-based investment firm Eurazeo for $611 million.

7 As part of an effort to meet the terms of its European Union bailout, the Greek government is selling a 10 percent stake in **Hellenic Telecommunications Organization** to Deutsche Telekom for $584 million.

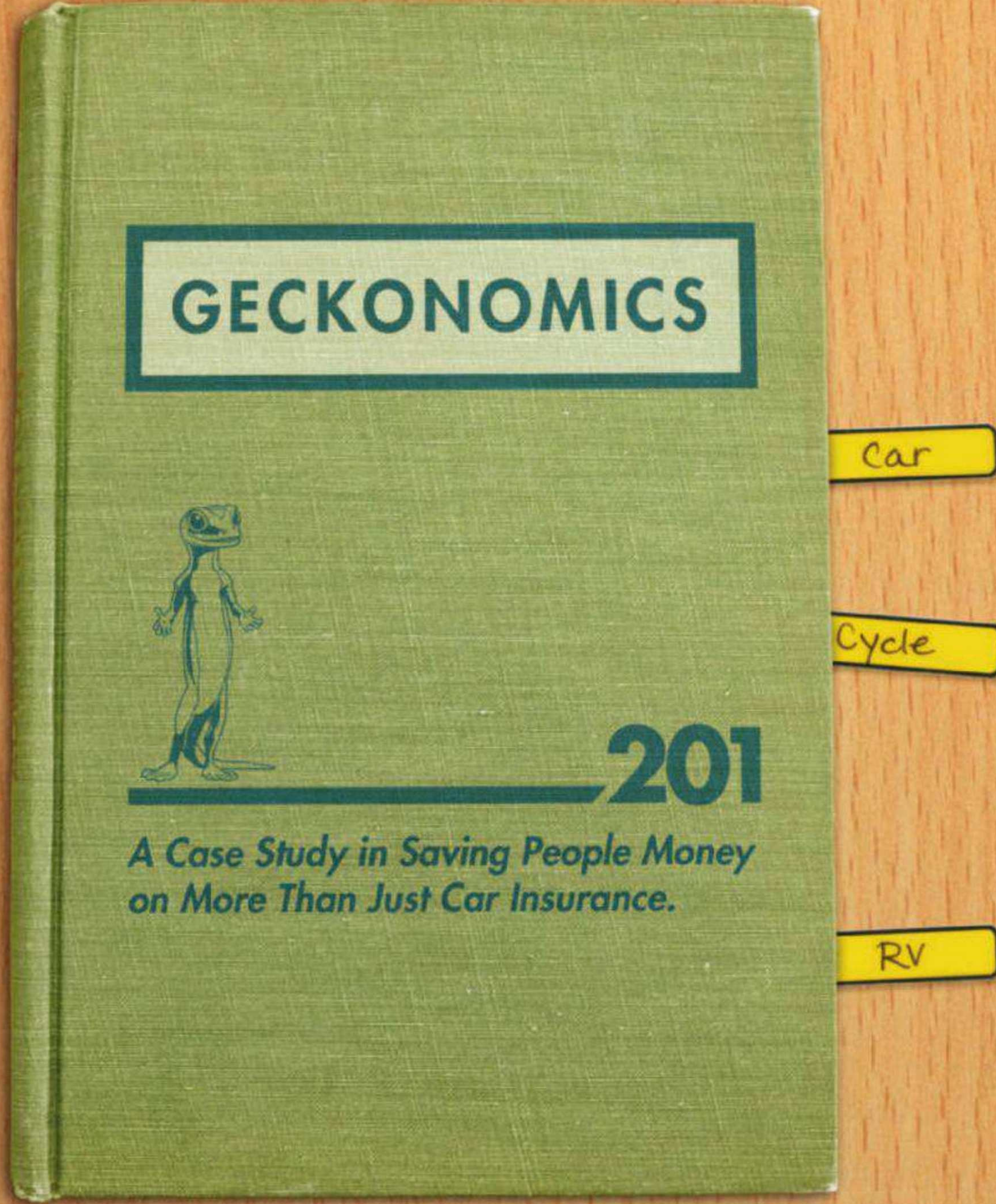
8 A South Carolina judge ruled that **Johnson & Johnson** must pay $327 million for deceptively marketing the antipsychotic drug Risperdal.

9 Joining a parade of tech IPOs, **Bankrate**, the online provider of interest-rate information, plans to raise as much as $320 million in a public offering.

10 Two bottles of the world's oldest Champagne, a **Veuve Clicquot** and a Juglar discovered last year after 170 years at the bottom of the ocean, sold at auction in Finland for $78,400.

LEX DAWSON/AALANDS LANDSKAPSREGERING/BLOOMBERG; DEFENSE DEPT.; SAKU TAKAKUSAKI

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9 Ideas From Around the World to Fix the US Economy

By Peter Coy

Democrats and Republicans are dug in like soldiers at Verdun over what to do about the sputtering U.S. economy. Exhausted by the political stalemate, they've been reduced to magical thinking, hoping that things will eventually get better by themselves. But time isn't on America's side. The country is suffering its highest average duration of unemployment since at least 1948. "The longer this goes on, the greater the danger that the cyclical downturn becomes structural. People and things that lie idle start to lose their productive value. Then you're into all sorts of troubles," says Karen Ward, senior global economist at HSBC Holdings in London.

It may finally be time for Americans to consider ideas from a place that they don't usually look to for inspiration: the rest of the planet. The U.S.'s economic predicament does present some unique dilemmas. The Obama Administration has already pushed hard on the levers that countries usually use to get out of a slump, to little discernible effect. Short-term interest rates are near zero and fiscal stimulus is aggressive, judging from a budget deficit of about 10 percent of gross domestic product. David Rosenberg, chief economist at Gluskin Sheff & Associates, a Toronto-based wealth-management firm, says of the U.S.: "We're basically in uncharted territory."

Maybe so. But there are guideposts that can help point the way out. The U.S., after all, is not the first country to wrestle with how to restart growth despite budget deficits that constrain big-spending solutions. The challenge is how to apply lessons from other countries to shore up American weaknesses, without sacrificing the strengths that make the U.S., for all its troubles, the world's biggest economy.

To prod the conversation forward, *Bloomberg Businessweek* scanned the world and found innovative economic ideas in countries as diverse as Germany, Brazil, Singapore, and Thailand that are applicable to America's mess. The focus was on short-term solutions, but since there aren't a whole lot of miracle fixes to be had, we also considered some longer-term reforms that create a better environment for years of sustainable growth.

There's no guarantee that all of these ideas would work in an American context. But it's clear that some fresh, non-ideological thinking is needed. Says Dow Chemical Chief Executive Officer Andrew N. Liveris, a Greek-Australian-American and author of the book *Make It in America: The Case for Re-Inventing the Economy*: "People in the U.S. confuse big government and small government as the only two models. What we need is smart government." By that he means government that puts business objectives ahead of politics. "Countries are competing like companies more and more," says Liveris, "In the U.S., we haven't caught up." Here are nine ideas from the rest of the world to get America back in the race.

WorldMags

From:

Germany

Idea:

Minimize Mortgages

Germany has one of the lowest homeownership rates among wealthy nations—around 46 percent, vs. two-thirds in the U.S.—and also one of the most stable housing markets. Prices of owner-occupied housing in Germany are up 9 percent since 2003, according to the Association of German Pfandbrief Banks.

What's the German formula? Housing is less vulnerable to booms and busts because only highly qualified buyers can get a mortgage. Down payments are usually at least 20 percent, often 40 percent. Mortgage interest is not tax-deductible, as it is in the U.S., which also discourages excessive leverage. Germans are justly proud of their Pfandbrief, an ultrasafe bond whose collateral is a set of standardized mortgages whose loan-to-value ratio can't exceed 60 percent. The bank that sells a mortgage-backed Pfandbrief to investors retains all the risk of default, giving it the incentive to underwrite cautiously.

The lesson for the U.S.? Tougher lending rules would help lower the risk of another housing crash. And in the long run, Americans may have to accept a lower homeownership rate to pay for taking the boom and bust out of the market.

HOMEOWNERSHIP RATES, 2007

68%	46%
U.S.	GERMANY

From:

Turkey

Idea:

Open the Doors

Is America still a land of opportunity for foreign investors? By some measures, yes. Foreign direct investment in U.S. companies, factories, mines, and land was nearly $200 billion in 2010, above its average for the preceding decade. Yet compared with Turkey, the U.S. looks unwelcoming. Turkey's Investment Support and Promotion Agency serves as a single point of contact for all permits, licenses, and land acquisition. It coordinates specialized training for the workers that multinational companies need and arranges for upfront tax breaks. Its staff can communicate in Arabic, Chinese, English, French, German, Italian, Japanese, Korean, Russian, and Spanish, as well as Turkish.

Dow Chemical CEO Liveris calls the agency a role model. "Today the U.S. is perceived as a risky place to do business by foreign companies," he says. Dow recently announced a joint venture with a Turkish company to make carbon fiber and derivatives for use in wind turbines and the like. A Turkey-style mix of tax incentives, language and job-training services, and legal assistance might persuade more foreign firms to invest in the U.S., creating jobs.

From:

Brazil

Idea:

Pay the Poor

On June 2, President Dilma Rousseff announced a plan called Brasil Sem Miséria (Brazil Without Poverty) that aims to lift 16 million people out of extreme poverty, defined as household income of $45 or less per month. The plan calls for providing the poor with job training, legal documentation, electricity, literacy, medical treatment, day care, and sanitation. Even garbage pickers are covered: The program aims to integrate them into municipalities' recyclable collection.

America's poor are rich compared with Brazil's, but growing income inequality poses dangers to the U.S.'s economic health. "Some poor people are so far behind that they can't open the doors" to opportunity, says Brazilian Executive Secretary for Social Development Rômulo Paes, a physician with a PhD in epidemiology. Improving coordination of anti-poverty policies would help more low-income Americans get back on their feet and give a boost to the recovery.

HOMEOWNERSHIP: ALEX J. POLLOCK, CENSUS BUREAU; BRAZIL: MINISTRY OF SOCIAL DEVELOPMENT

From:

Canada

Idea:

A Worthwhile Tax

With the 2012 Presidential election looming, the idea of springing any new taxes on the American public verges on heresy. But digging out of our fiscal hole will require the government to find ways to increase tax revenues one way or the other. For a start, look north. Unlike the U.S., Canada has a national sales tax–the Goods and Services Tax, currently levied at 5 percent. Consumption taxes such as these are less harmful than a tax on wages and salaries (which discourages work) or a tax on investment (which discourages saving). Livio Di Matteo, an economist at Lakehead University in Thunder Bay, Ont., believes the U.S. could go a long way toward solving its budget problems with a national sales tax and a fatter gasoline tax. "The U.S. is a rich country," he says, "and its deficit situation is more a political rather than economic problem." Consumption taxes might be one "worthwhile Canadian initiative" that's worth a closer look.

FEDERAL SALES TAX

5%	0%
CANADA	U.S.

SALES TAXES: CANADA REVENUE AGENCY, INTERNAL REVENUE SERVICE

From:

China

Idea:

Go Green

Looking to China for economic lessons is a fraught proposition. China's authoritarian system allows the central government to play a role unimaginable in the U.S. Borrowing selectively from Beijing's playbook, however, can help revitalize American industry. China's 12th Five-Year Plan commits the country to world leadership in seven leading-edge industries, many of them connected to clean energy and the environment. An article released by the government's Xinhua News Agency cited unnamed analysts' estimates that investment in environmental protection alone will exceed 3 trillion yuan–about half a trillion dollars–from 2011 to 2015. By contrast, government-funded research and development in the U.S. is heavily tilted toward the National Institutes of Health. Innovations in the health sector may extend lives, but they could, perversely, increase health-care costs by producing costly new drugs and devices–while delivering a smaller commercial payoff than the green industries on which China is focusing.

CHINA'S SEVEN TARGETED INDUSTRIES: 1. ENERGY SAVINGS AND ENVIRONMENTAL PROTECTION 2. NEXT-GENERATION INFORMATION TECHNOLOGY 3. BIO INDUSTRIES 4. HIGH-END ASSEMBLY AND MANUFACTURING INDUSTRIES 5. NEW ENERGY SOURCES 6. NEW MATERIALS 7. ELECTRIC CARS

From:

Singapore

Idea:

Keep Workers Working

The famously efficient city-state was uniquely vulnerable to the worldwide economic downturn because it depends on global trade, which dropped off sharply. Yet Singapore's unemployment rate topped out in 2009 at just 3.3 percent. One factor was the Jobs Credit program, which pays employers to keep people on the payroll until demand revives. Other countries with similar programs include Belgium, Finland, Germany, and Japan.

That's not all Singapore does. Its SPUR (Skills Programme for Upgrading and Resilience) pays companies to train workers while they are idle instead of laying them off. Some workers are trained for jobs in fields their employer isn't even in. The government guides entire industries toward the future it envisions for them, says G. Jayakrishnan, Americas group director in New York for International Enterprise Singapore, a trade promotion agency.

Such a paternalistic government role would be tough for American companies to stomach. Yet in Singapore, says Jayakrishnan, "it really puts the country and the economy on the right side of things when the economy begins to pick up."

LABOR-EMPLOYER RELATIONS RANKINGS

1	33
SINGAPORE	U.S.

From:

Thailand

Idea:

Cheap Rooms!

To get its economy going again in 2009, Thailand doubled the tax deduction for domestic hotel stays as a way to encourage people to get out and spend money. It was only a small part of Thailand's recovery package, but it caught people's attention. In an e-mail, Thai Finance Minister Korn Chatikavanij says, "These measures helped with morale and 'bought time' for us to do 2 things: 1) employ the main stimulus measures which were investment-based and, 2) wait for export demand to pick up thru global recovery, which they did." The U.S. has already resorted to similar gimmicks to goose demand: The 2009 stimulus package included, among other things, tax breaks for purchases of RVs. But the slow recovery suggests that American consumers need more incentives to spend.

RANKINGS: WORLD ECONOMIC FORUM

WorldMags

[redacted]

From:

Australia

Idea:

Give the Kids a Break

Beginning July 1, Australian pensioners will get improved "work bonuses" to find part-time jobs or stay longer in the workforce. Matthew Weinzierl, an economist at Harvard Business School, likes Australia's idea of varying tax rates by age, but he'd do it differently: Have tax rates rise steadily from age 25 to age 55. By paying lower taxes when they're young and more when they reach middle age, Americans would essentially borrow from their older, richer selves. Weinzierl didn't focus on the older workers targeted by Australia because he didn't want to complicate the analysis with retirement decisions.

The HBS economist estimates that varying income tax rates by age would generate social-welfare gains equaling 0.6 percent to 1.5 percent of annual U.S. consumption. That's in the range of $100 billion a year. A more efficient tax code would also encourage people to work more, generating wealth. But Weinzierl cautions that age-based tax rates won't end the slump: The big problem now is there's not enough work to be done.

[redacted]

From:

Israel

Idea:

Swords Into Software

The U.S. is by far the world's largest spender on the military and intelligence. But the Pentagon could learn something from Israel about how to convert defense dollars into commercial products that can benefit the broader economy. Veterans of a single unit of the Israeli Defense Forces' Intelligence Corps have launched such successful ventures as Check Point Software Technologies, the network security software company; ICQ, the pioneer of instant messaging; and NICE Systems, which detects fraud. The secretive operation, called Unit 8200, serves as the corps's technology intelligence unit. Ido Aharoni, Israel's consul general in New York, says the closest thing America has is DARPA, the Defense Advanced Research Projects Agency. But no one in the Pentagon is responsible for getting commercial bang for military bucks. That makes it fertile ground for improvement. Ⓑ

MILITARY SPENDING AS SHARE OF GDP

4.7%	6.3%
ISRAEL	U.S.

MILITARY SPENDING: STOCKHOLM INTERNATIONAL PEACE RESEARCH INSTITUTE

WorldMags

Does the Mormon faith build better leaders?

God's MBAs

By Caroline Winter
Illustrations by Brandon Bird

Before setting out in orderly pairs to spread their gospel door-to-door, nearly all U.S. Mormon missionaries pass through the Provo Missionary Training Center. Inside the sprawling brown-brick complex, thousands of 19- and 20-year-old men in oversized black suits work alongside women in below-the-knee skirts and brightly colored tops. All of them wear name tags.

For one to three months (depending on the language challenge ahead), their days begin at 6:30 a.m. and end at 10:30 p.m., and include 10 hours of class and study time. On their one day off per week, missionaries-to-be do laundry, write home, and stock up on supplies at the training center store where pre-knotted ties ($15-$20) and key-chain rings with screw-top vials for carrying consecrated oils ($3.50) hang beside highlighters, alarm clocks, and hymnbooks translated into roughly 50 foreign languages. The grounds are under tight security, and no one leaves without permission. This is the last stop for roughly 20,000 young Mormons each year before they're driven 45 miles north to Salt Lake City International Airport and whisked off to one of more than 150 countries to make converts.

The Provo Missionary Training Center (MTC) and its curriculum are designed to render all trainees equal servants of the Church of Jesus Christ of Latter-Day Saints (LDS), yet many of the men who prepared for their missions here, or at the center's earlier incarnations, have gone on to become among the most distinguished and recognizable faces in American business and civic life. There's Mitt Romney (mission:

WorldMags



Nolan D. Archibald, *former CEO of Stanley Black & Decker, 1986-2010* | Jeremy Andrus, *CEO of Skullcandy, 2011-present* | J. Ralph Atkin, *founder of SkyWest Airlines* | Gary S. Baughman, *CEO of Fisher-Price, retired 1999* | Michael J. Bertasso, *senior vice-president of H.J. Heinz Asia Pacific, 2002-2005* | L. Todd Budge, *CEO of Tokyo Star Bank, 2003-2008* | M. Anthony Burns, *CEO of Ryder Systems, 1983-2000* | Allan O'Bryant, *president of AFLAC International (retired 2005), Japan CEO of Reinsurance Group of America, 2011-present* | Francis W. Cash, *CEO of La Quinta Properties, 1999-2006* | Dave Checketts, *CEO of Madison Square Garden, 1994-2001, president of the New York Knicks 1991-1994* /

France), who as of 2007 had amassed an estimated $190 million to $250 million as head of Bain Capital, rescued the 2002 Salt Lake City Winter Olympics from a corruption scandal, spent four years as the governor of Massachusetts, and announced his second run for President on June 2. His potential rival for the Republican nomination is Jon Huntsman Jr. (Taiwan), a former Utah governor who negotiated dozens of free-trade agreements as a U.S. trade representative and served as ambassador to China from 2009-2011. The list also includes JetBlue founder David Neeleman (Brazil), Credit Suisse Chief Executive Officer Eric Varvel (who confirmed training at the Provo MTC but would provide no more information), self-help mogul Stephen Covey (England), author of *The 7 Habits of Highly Effective People*, Kim Clark (Germany), former dean of Harvard Business School, and Gary Crittenden (Germany), who's served as CFO for Citigroup, American Express, and Sears Roebuck.

Gary Cornia, dean of Mormon-run Brigham Young University's Marriott School of Management, is often asked what makes Mormons so successful. "I'm not going to say we beat everybody out, but we do have a reputation," says Cornia. "And one of the defining opportunities for young men and young women is the mission experience." Reflecting on his own mission to the mid-Atlantic states, Cornia adds, "When I left, the son of a relatively poor mother and a father who died when I was young, I frankly didn't know if I could do anything. I came back with the confidence that I can accomplish most hard things. I may not have had that otherwise."

The Mormon Church is 181 years old, and its adherents compose less than 2 percent of the U.S. population, according to a 2009 American Religious Identification Survey (ARIS). Yet Latter-Day Saints hold, or have held, a seemingly disproportionate number of top jobs at such major corporations as Marriott International, American Express, American Motors, Dell Computers, Lufthansa, Fisher-Price, Life Re, Deloitte Touche Tohmatsu, Madison Square Garden, La Quinta Properties, PricewaterhouseCoopers, and Stanley Black & Decker. The head of human resources at Citigroup is Mormon, and in 2010 Goldman Sachs hired 31 grads from BYU, the same number it hired from the University of Pennsylvania's Wharton School.

There's a risk of stereotyping in drawing conclusions about any religion based on a sampling of its exceptional adherents, but church leaders and Mormon businessmen embrace the idea that there's a relationship between the missionary experience and success in business. "The mission is like a crucible experience [and] a lot of people come out with the capacity to lead," says Clark, who left HBS in 2005 to preside over BYU-Idaho at the request of the LDS Church's then president, Gordon Hinckley, regarded by Mormons as a living prophet; as Clark tells people, "It was like getting a phone call from Moses."

Almost all of the Mormon businessmen contacted for this story—the teachings of the church encourage women to stay home—see a connection between their faith and their work. (Romney and Huntsman did not respond to interview requests.)

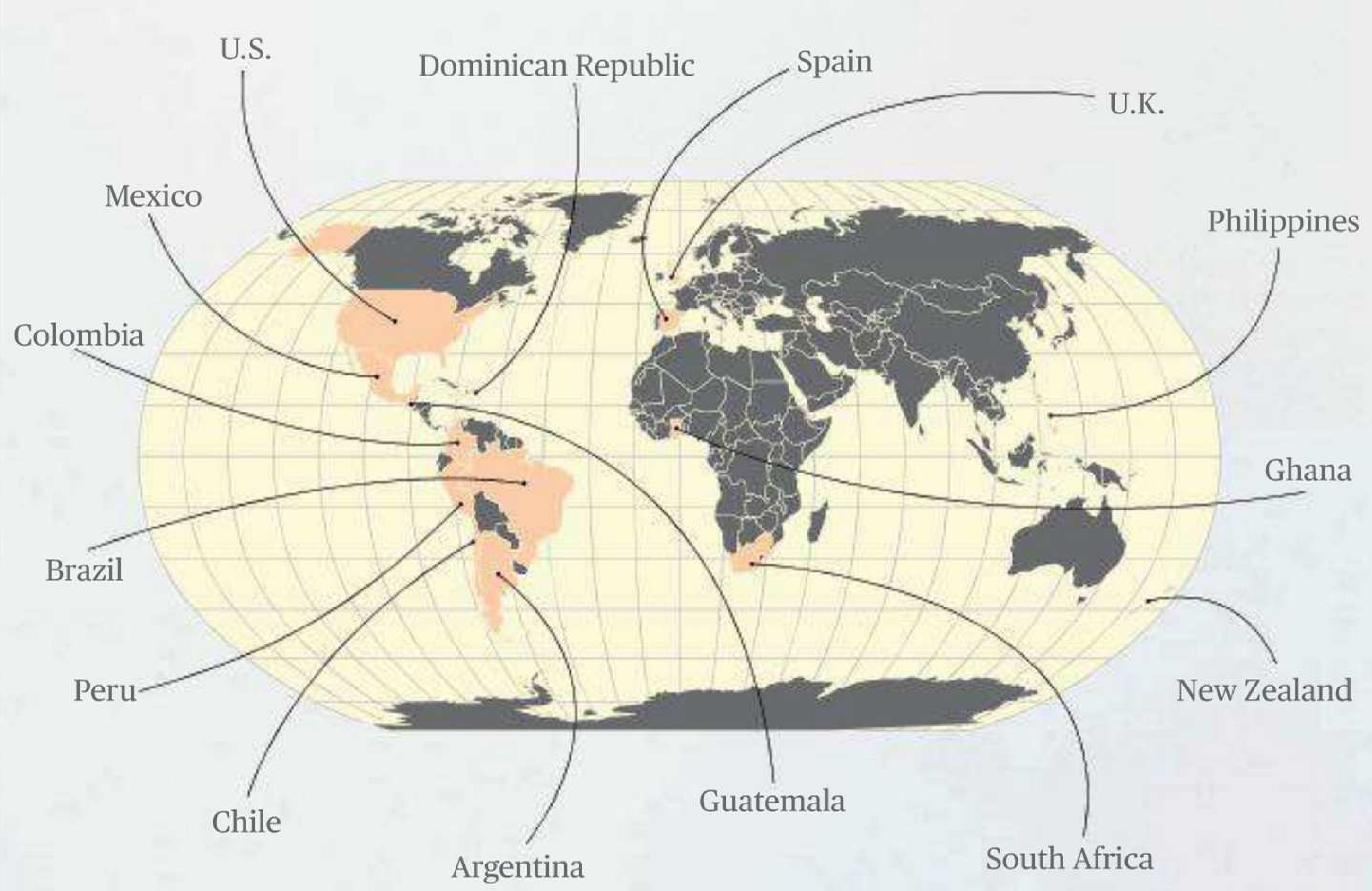
So far the church has sent over 1 million missionaries into the world. All young Mormon men, referred to as "elders," are asked to serve a mission if they are in good standing. Young women, called "sisters," serve voluntarily and make up about 20 percent of the missionary force. Roughly 50 percent of U.S. Mormon missionaries go abroad to countries as disparate as Albania, Ghana, Micronesia, and France, with each individual's placement a matter of "divine inspiration," according to the Provo MTC's director, Richard I. Heaton. Young Mormons submit their medical records and basic CVs to the "Twelve Apostles," who in stature rank just below the church's president. The group then prays to find out where each individual is needed.

Once on site, missionaries pay a $400 share of their room and board and are required to live as the locals do. "The wonderful thing is that you don't experience Korea from the 25th floor of the Hyatt," says Harvard Business School professor Clayton Christensen, a Rhodes scholar and board member at India's Tata Consultancy Services, who did his mission in Korea from 1971 to 1973. "They don't have air conditioning, you don't have air conditioning; they don't have plumbing, you don't have plumbing."

Each elder or sister spends every moment of every day in tandem with another, sleeping and rising at the same time in a shared room. That companion isn't always American and doesn't necessarily speak English. For the next two years, these "companionships" proselytize for 10 hours a day, six days a week, knocking on doors and offering *The Book of Mormon* to strangers, often in languages the missionaries barely know how to speak. They must persuade people to listen and learn to persevere in the face of near-constant rejection. "I don't think there's any more demanding profession than being a Mormon missionary," says Christensen.

International Men of Missionary

Around 80 percent of missionaries are trained in Provo, Utah, but there are 14 other missionary training centers around the world



DATA: CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS

Don R. Clarke, *president of Lord & Taylor, 1998-1999* | Jonathan C. Coon, *co-founder and CEO of 1-800-Contacts, 1994-present* | Gary L Crittenden, *former CFO of Citigroup, 2007-2009, former CFO of American Express, 2000-2007* | Robert C. Gay, *co-founder and CEO of Huntsman Gay Global Capital, 2007-present* | Thomas R. Grimm, *CEO of Wal-Mart's Sam's Club division, 1998-2002* | Lloyd Hansen, *vice-president of Ford Motor* | Rodney A. Hawes Jr., *CEO of Life Re, 1988-1998* | Jon Huntsman Sr., *founder and chairman of Huntsman Corp., 1970-present* | Jon Huntsman Jr., *Deputy U.S. Trade Representative under President George W. Bush, U.S. Ambassador to China, 2009-2011* | Van R. Johnson, *CEO of Sutter Health, 1995-2005* |

Over the course of a mission, each individual rotates through two or three companions, an experience that forces the development of interpersonal skills, according to Joseph Ogden, assistant dean at BYU's Marriott School. One person is always assigned a senior role, usually on the strength of time served. Sometimes seniority is assigned by church officials' assessment of leadership abilities. Ogden remembers being given senior status over a 26-year-old ex-Green Beret while on his mission to Australia. "I was this lanky teenager ... and you could tell he really wanted to be in charge," says Ogden. "That was a tough one."

Missionaries aren't allowed access to news and are only permitted two phone calls home each year, on Mother's Day and Christmas. Guidelines are laid out in a pocket-sized handbook that Provo MTC President Gordon D. Brown says helps them to focus, stay safe, and integrate faster. The book has instructions on a wide range of activities: Full-court basketball games, for example, are banned, while half-court is permissible. Returned missionaries say that simply abiding by all the rules is enough to impart a sense of accomplishment.

Serving abroad helps Mormons learn languages (around 70 percent of BYU students are bilingual). It also seems to provide them with insight into foreign cultures and economies, an asset many missionaries have used to start businesses and careers. Neeleman served in Brazil and, after founding JetBlue Airways, went on to start Azul Airlines, a domestic Brazilian carrier. L. Todd Budge, chairman of Tokyo Star Bank, used his mission experience in Japan to become the first non-Japanese CEO of a Japanese bank and says he may never have gone abroad at all if the church had not sent him. Allan O'Bryant, now Japan CEO at Reinsurance Group of America, served in Japan and later became the president of AFLAC International.

Mitt Romney served in France from 1966 to 1968, after his freshman year at Stanford University. Widespread anti-American sentiment at the time made proselytizing especially difficult; in a 2007 *New York Times* article, Romney described his mission as humbling, saying it was the only time in his life "when most of what I was trying to do was rejected."

As the son of George Romney, the ex-American Motors CEO who was then governor of Michigan, Mitt Romney enjoyed privileges unheard of for most



elders and entered the mission field of Bordeaux and Paris having completed three years of French at Michigan's elite Cranbrook School. Once on site, Romney broke handbook rules to sneak out to the movies and eat coq au vin, and used his father's connections to arrange a meal at the American Embassy, according to the *Times*. Still, Romney has credited the experience with deepening his faith and ambition. Eager to move up through the missionary ranks, he experimented with innovative means of getting out the Mormon Word, like hosting "American night" at a local café and staging an exhibition baseball game. According to *The Washington Post*, he also pitched articles about Mormons to newspapers and even tried proselytizing at bars.

Romney's mission was marred by tragedy. On June 16, 1968, he was asked to chauffeur the couple presiding over the region's missionaries and was at the wheel during a head-on collision that killed the mission president's wife. Romney was left unconscious and so badly mangled that a police officer mistakenly pronounced him dead. He was rushed to the hospital and found to have a concussion, fractured ribs, and a broken arm.

When the mission president returned to the U.S. to bury his wife, Romney was asked to take charge of the region's missionaries, who numbered around 200. He thrived in the position, traveling across France to lead conferences. Under his leadership, France's missionaries exceeded 200 baptisms for the first time in a decade.

Dave Checketts is chairman of the sports, entertainment, and media enterprise SCP Worldwide, the owner of the St. Louis Blues, and a Mormon whose past titles have included CEO of Madison Square Garden. Checketts served his mission in East Los Angeles, mostly walking the streets of neighborhoods such as Compton, Whittier, and Boyle Heights. The hardest part, he says, was splitting from his comparatively comfortable teenage life. "You leave your family, your friends, your car, you don't date for two years, and you're 19 years old," he says. "I missed my freedom, I missed going out to eat—I was suddenly working hard, knocking on doors, trying to find people who would listen, dressing every day in a shirt and tie, whereas before I probably had on a T-shirt and jeans."

In witnessing extreme poverty and wealth, Checketts says he understood that he needed to take responsibility for his future. Upon returning to college, he shot to the top of his class and later became president of the National Basketball Assn.'s Utah Jazz at the age of 28. "What happens on a mission is that you grow up pretty fast," he says. "You're dealing with adult problems and adult issues, because when you're teaching somebody the gospel of Jesus Christ, you're typically meeting people who want to improve their lives ... and you kind of get a sense for how you'd like to live your life; you get serious about life, about school, about work."

Kevin Rollins, the former CEO of Dell Computers and currently a senior adviser to TPG Capital, says the rejections spiked with occasional successes that he experienced during his mission in Alberta and Saskatchewan, Canada, prepared him for entrepreneurship. "When you get into the business world, most of what you try doesn't work either," he says. "And so the notion of having focus and determination, working hard, and leading others along with you, those principles are all things you would look for in a corporate executive, vs. someone who closes his tent after one little disappointment."

Mormons, who consider their faith to be a Christian denomination, take Biblical exhortations to

BOOK: DAVIES + STARR/THE IMAGE BANK/GETTY IMAGES

Steven J. Lund, *CEO of Nu Skin Enterprises, 1998-2003* | J.W. "Bill" Marriott Jr., *chairman of Marriott International, 1972-present* | D. Reed Maughan, *partner at PricewaterhouseCoopers, 1998-2010* | Paul McKinnon, *head of human resources at Citigroup, 2008-present* | David Neeleman, *founder and CEO of JetBlue Airways, 1998-2007, and Azul Brazilian Airlines, 2010-present* | Ray Noorda, *CEO of Novell, 1983-1996* | Melvin E. Olsen, *American Airlines, vice-president, retired 1998* | James H. Quigley, *CEO of Deloitte Touche Tohmatsu, 2007-2011* | Ronald E. Robison, *managing director, operations at Morgan Stanley Investment Management, retired 2008* | Kevin B. Rollins, *CEO of Dell Computer, 2004-2007*

work hard to the extreme. "Mormonism is kind of like the Puritan ethic on high," says Nathan Furr, assistant professor of entrepreneurship at BYU's Marriott School. "There's total emphasis on self-sufficiency, on working hard."

This aspect of the missionary experience is rooted in the religion's origins and permeates all aspects of Mormon life. Utah Governor Gary R. Herbert, a seventh-generation Mormon whose relatives were among the state's original settlers, admires the Mormons who found Utah after leaving behind New York, Ohio, Illinois, and Missouri. Settlers, in his words, "harnessed the snowpack and built reservoirs and canals and ditches, and ... literally made the desert blossom like a desert rose." Herbert's account could be straight from *The Book of Mormon*'s version of how the land of Helam was made fruitful: "And they pitched their tents, and began to till the ground, and began to build buildings; yea, they were industrious, and did labor exceedingly."

Simply belonging to the highly managerial Mormon Church requires work. Mormons depend upon an unpaid "lay" clergy composed of ordinary congregants tapped to lead sermons each week. Congregants don't just go to church on Sunday, they run the church, filling all the positions from Sunday school teacher to bishop, serving an estimated five to 25 hours each week. At the same time, they are expected to pay a 10 percent tithe on their incomes while encouraged to raise large families. Only those who tithe are given "temple recommends," passes which are required to enter Mormon temples.

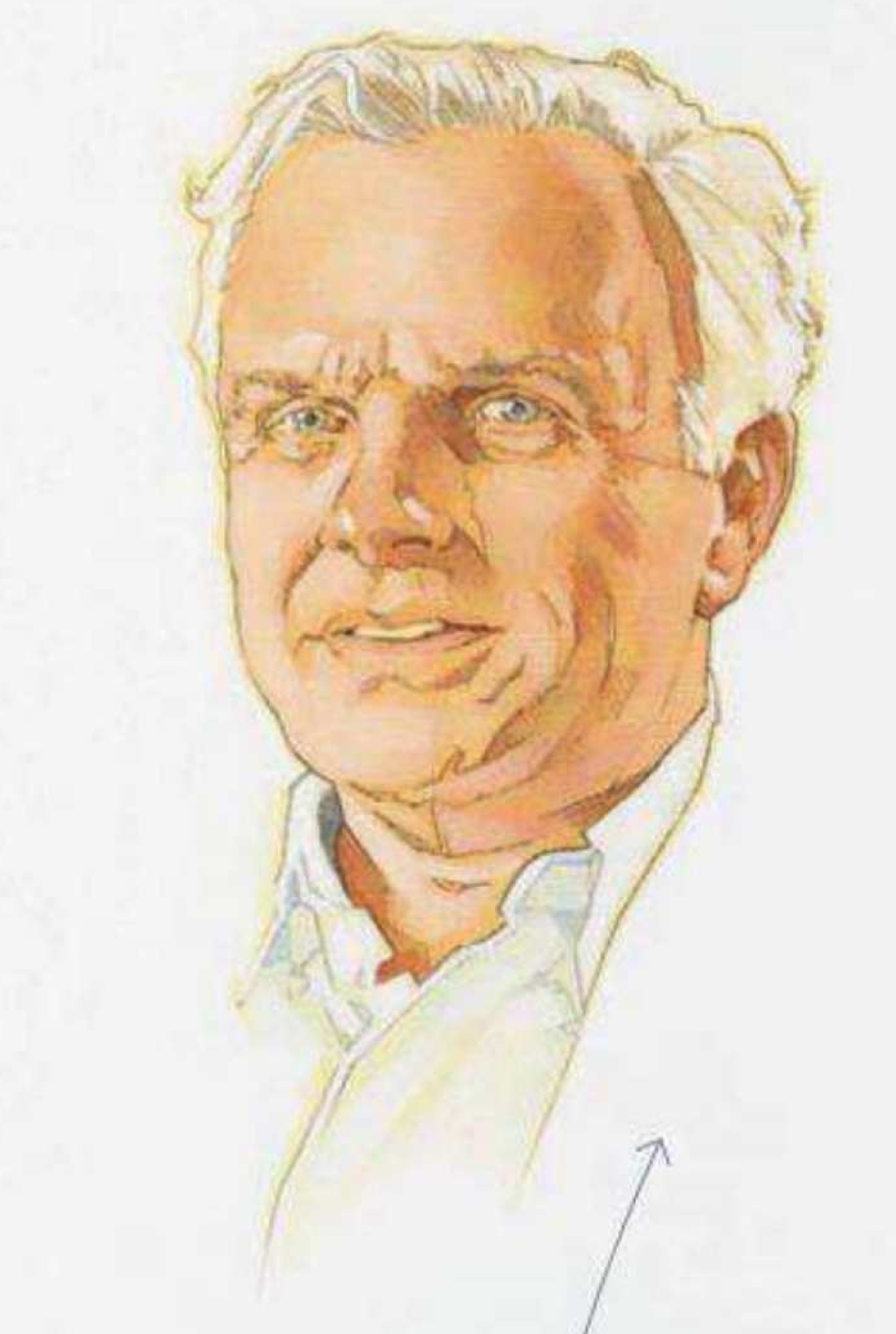
Church obligations start early. "Children at a very young age begin to learn things that leaders have to do—speak in public, interact with people, teach," says Kim Clark. Public speaking starts with two-minute presentations at the age of three, according to Kim Farah, a spokeswoman for the church. The goal is to "help them internalize their beliefs," she says, and any professional benefits are secondary. Mormons don't undergo grueling Battle-Hymn-of-the-Tiger-Mother upbringings, but teenagers are expected to get up early and attend seminary one hour before school, five days a week. Kids age 12 through 18 progress through hierarchical rings of youth groups, each of which has two or three appointed leaders who learn to hold meetings, take responsibility for their groups, and check on members who aren't attending church regularly. One former Latter-Day Saint, a facial plastic surgeon from Brazil named Marcello Jun de Oliveira, says church commitments are so intense that "when you finally start a job, it's just like church—it's so much work."

One former Latter-Day Saint says, "When you finally start a job, it's just like church—it's so much work"

Kevin Rollins, whose Mormon roots go back to the religion's founders (and who says he worked 20 hours a week for the church while putting in another 100 hours at Dell), remembers conducting youth group meetings as a child. "You learn by experience that it's better to have an agenda, have a plan, have a structure, have people participating ... and if you have to discipline somebody, you learn to do that in private," he says. When Dell hired him from the consultancy Bain & Co. to head up the company's Americas division—accounting for 70 percent of the company's revenue at the time—Rollins had no prior experience as an executive. "I can still remember, I was at my first meeting at Dell ... and there were, oh, I don't know, 12 executives, and I think they were stunned at how I came in and ran the meeting, knowing how to run a meeting from all the times I had run one as a church member," he says. "I really owe most of that natural instinct there to the training I received as a young kid."

The church itself is a well-run global conglomerate. Ryan T. Cragun, an assistant professor at the University of Tampa and president of the Mormon Social Science Assn., says the church likely owns more acreage than there is in the state of Delaware. In Florida alone, he says, Mormons own 10 times as much land as Walt Disney, including a $1 billion for-profit cattle and citrus ranch. The LDS Church also owns commercial hunting grounds, radio stations, newspapers, real estate developers, shopping centers, and a land management company in Hawaii. Churches in the U.S. are not required to report their finances, and the Mormon Church does not, but the *Financial Times* in 2010 estimated the LDS Church's worth at $25 billion to $30 billion.

Mormons insist that self-improvement and self-reliance, not material wealth,



are their religious aims, yet the Book of Mormon states, "And thus they did prosper and become far more wealthy than those who did not belong to their church" (Alma 1:31). The same passage goes on to explain why non-Mormons fall short: "For those who did not belong to their church did indulge themselves in sorceries, and in idolatry or idleness, and in babblings, and in envyings and strife; wearing costly apparel; being lifted up in the pride of their own eyes." Armand L. Mauss, professor emeritus of Sociology and Religious Studies at Washington State University, notes that "Mormons tend to assume that if they are doing their best in meeting their religious obligations, God will bless their worldly efforts."

In fact, Mormons fall in the middle of the socioeconomic spectrum, their numbers perhaps skewed lower by recent converts who tend to be less educated and less wealthy, according to Furr and others. Even so, Latter-Day Saints are less likely than the general public to be in the lowest income bracket, according to the Pew Research Center.

BYU's Marriott School, housed inside a bland box of tinted glass and gray pebble slabs, is a 10-minute drive from the Missionary Training Center and 2,000 miles from Wall Street. Most high-ranking business schools are located in major urban centers; BYU has Provo, a city of roughly 100,000, laid out on a grid of colossal six-lane streets built up into a maze of housing developments,

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George Romney, *CEO of American Motors, 1954-1962, governor of Michigan, 1963-1969* | Mitt Romney, *co-founder and CEO of Bain Capital, 1984-'89 & 1991-'99, governor of Massachusetts, 2003-2007* | Blake Roney, *co-founder and chairman of Nu Skin Enterprises, 1996-present* | Harris H. Simmons, *CEO of Zions Bancorp, 1990-present* | Donald L. Staheli, *CEO of Continental Grain, 1988-1997* | Dieter F. Uchtdorf, *senior vice-president, Lufthansa, 1982-1996* | Eric Varvel, *CEO of Credit Suisse, 2009-present* | Mark J. Wattles, *founder and CEO, Hollywood Entertainment, 1988-2005* | Kay R. Whitmore, *CEO of Eastman Kodak, 1990-1993* | Raymond D. Zinn, *co-founder and CEO of Micrel, 1978-present*

hotels, and fast-food chains. Still, Dean Cornia says, "[Wall Street finds] it interesting enough to continue to hire. If we weren't producing, I don't think we'd end up there."

BYU's undergraduate business program ranked 11th last year, just behind Georgetown University, according to *Bloomberg Businessweek*'s annual rankings. BYU ranks No. 1 for invention disclosures, new patent applications, and startup companies spun out per every $1 million of research expenditure, according to the Association of University Technology Managers.

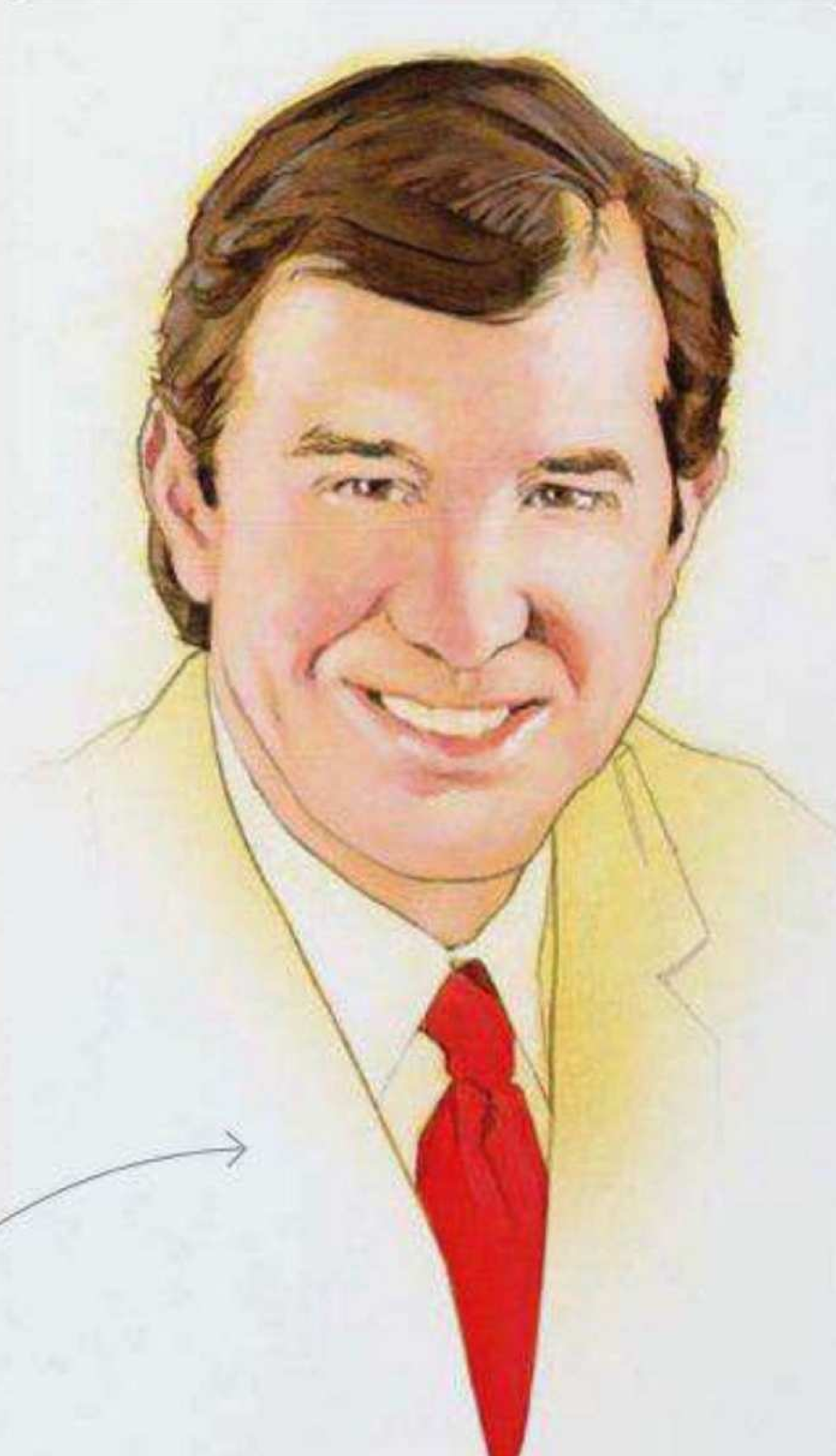
Of 127 full-time faculty members, Kristen DeTienne, a professor of organized leadership and strategy, is the sole non-LDS professor and, although she says she doesn't "buy into the religion," she is floored by the Mormon work ethic. "They have this song that they sing all the time, it's called *Put Your Shoulder to the Wheel*." After a shy attempt at the hymn, DeTienne corrals the school's PR manager, Chad Little, to provide a more polished rendition. He obliges in a sweet tenor: "The world has need of willing men/Who wear the worker's seal/Come help the good work move along/Put your shoulder to the wheel."

Non-Mormons who make a point of hiring Latter-Day Saints go back at least as far as Howard Hughes, who surrounded himself with Mormons, trusting them over others because of their reputation as hard-working teetotalers. Ronald Reagan also employed several LDS staffers and once declared, the "Mormon contribution to American life is beyond measuring," according to historian Michael K. Winder. DeTienne says she knows several executives at top companies who express enthusiasm about hiring Mormon employees, in part because they are often faithfully married, which tends to make them "more mature and better at managing their time, establishing priorities, working hard."

Mormon women are partners in those faithful marriages, yet they're almost absent from the business landscape. The Marriott School's MBA class of 2011 is only 12 percent female, compared with HBS's 36 percent, and although LDS spokeswoman Jessica Moody says Mormon women do hold leadership roles at small companies, none have reached the corporate leadership heights of Mormon men. Women are urged by the church to pursue education, but the Mormon Proclamation on the Family, which, according to religion scholar Mauss, attained near-canonical status after its issuance in 1995, says men should provide for families while women should raise children. In his 2007 book *The Mormon Way of Doing Business*, Mormon journalist Jeff Benedict includes a chapter titled "The Secret to Success," dedicated entirely to the stay-at-home wives of famous Mormon CEOs. "The wives' deep commitment to the home" is the glue that keeps Mormon families together, says Benedict, and also "vital to the success of these CEOs' performance at work."

Kevin Rollins stresses that both man and wife must be devoted to the family, but that in "the Mormon model, a woman would take care of the kids and the husband would assist her and go out and work and make all the money they need to survive." Scholar of Mormonism Melissa Proctor also notes, "A Mormon woman who has post-graduate education is less likely to attend church," perhaps because "an advanced degree does not contribute to an LDS woman's status within the church," whereas the church tends to fill its top positions with professionally successful men.

To some, the Mormon emphasis on success can seem restrictive. John Schultz, a 33-year-old warehouse manager in Toronto, opted for a "voluntary excommunication" in 2003 when his bishop scolded him for failing to tithe and missing Sunday services for work. His resentment toward the church had been building for some time. "Growing up [in the Mormon Church], there was all this focus on the middle-class lifestyle, on going to college," he says, explaining why he felt like a misfit. "You had to look a certain way and act a certain way." Schultz theorizes that the church's insistence on a middle-class appearance is PR to win mainstream acceptance and recognition as a Christian faith. "In religious and theological communities, Mormons are always pushed to the side," says Schultz. "If they're even considered Christian by the Christian majority, they consider that a huge gain. I think that's exactly why there's the pressure to put on this face."



De Oliveira, the Brazilian surgeon, considers himself a secular Mormon. He left the church because of its role in dismantling gay marriage in California and because of what he described as classism in his chapel. De Oliveira, who notes that the vast majority of new converts are poor, witnessed the church's influence in making some low-income families upwardly mobile, while several others spoke with him about feeling excluded by wealthier congregants who held all the top leadership positions. "Here in Brazil, I attended a ward [parish] for half a decade where the chapel would literally, and physically, split itself down the aisle," he says.

At the Salt Lake City airport, three teenage elders in white shirts and black suits are headed to Brazil on 24-month missions. Only one of them has been outside the U.S. They say they're fully prepared for their undertaking and have never felt as much love as during their training period at the Provo MTC ("with 3,000 young men dedicated to serving"). Elder Hildebrandt, 19, says he can't wait to be changed by his mission. "It's only two years," he says. "People come back, and they're just totally different ... they don't need mom anymore."

As for the prospect of having two Mormon Presidential candidates in 2012, the elders say they're not generally interested in politics. None have heard of Jon Huntsman, and they don't have much to say about Romney. Upon reflection, though, Elder Hildebrandt says, "One good thing about having a Mormon President—we'll be able to hold him to a higher standard." B

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Lagarde En Garde

**The French finance minister is smart, polished, and a welcome relief after the Strauss-Kahn scandal. She's the clear front-runner to lead the IMF—the question is whether she's the right person for the job.
By Carol Matlack**

Opposite: ▶ Lagarde on the carpet in her Paris office

Things were unraveling fast as the council of European finance ministers rushed to Brussels on the afternoon of Sunday, May 9, 2010, to try to rescue the euro. The previous week, global markets had plunged on fears that Greece's sovereign debt crisis could spread to other euro zone countries, exposing already weakened banks to possible defaults. With Asian trading set to open in a few hours, the ministers were under pressure to act quickly to avoid a panic sell-off of Europe's common currency. Then, just as council Chairwoman Elena Salgado of Spain was calling the meeting to order in a cavernous hall buzzing with ministers, aides, and translators, more bad news arrived: Wolfgang Schaeuble of Germany, Europe's biggest economy and a key player in the talks, had fallen ill and been hospitalized. The Germans were sending a replacement, who wouldn't arrive for more than an hour. Christine Lagarde, the French finance minister, called for a recess, then withdrew to a private office down the hall.

If ever there was a moment for Lagarde to show how she might handle a crisis as head of the International Monetary Fund, this was it. For the next several hours, her temporary office became the hub of global negotiations that produced an unprecedented trillion-dollar rescue package for the euro. Seated on a couch, Lagarde juggled dozens of phone calls from government officials, according to an aide who did not wish to be identified. Among them was a conference call with U.S. Treasury Secretary Timothy F. Geithner and other non-European finance ministers. Every 30 minutes or so, Lagarde dialed in to Basel, Switzerland, where European central bankers and IMF Chief Dominique Strauss-Kahn had gathered. When Schaeuble's sub, Interior Minister Thomas de Maizière, landed in Brussels, he came to Lagarde's office to brief her on Germany's position. Others drifted in and out, including Salgado and Olli Rehn, the European Union Commissioner for Monetary Affairs. Occasionally, Lagarde took people aside for one-on-one chats.



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By 2 a.m., consensus had formed around a plan to backstop troubled euro zone economies by issuing bonds guaranteed by the 16 euro zone members as well as other EU countries and the IMF. As day broke in Asia, stock and bond markets rose after the ministers released a communiqué detailing the plan. Despite her outward composure during the talks, Lagarde admitted to Bloomberg News later that she had been frightened the euro might collapse. "I felt like, 'Oh my God, it could all go down the tubes.'"

Lagarde's role that night helps explain why she's now the leading candidate for one of the most important jobs in global economic policy. By June 30, the IMF is expected to name a replacement for Strauss-Kahn, who resigned on May 18 to defend himself against charges of sexually assaulting a New York hotel maid. Lagarde appears to be the one to beat, though critics say it's time the IMF named a leader from an emerging-market country. Among those who have expressed interest are Agustin Carstens, Mexico's central bank governor, as well as Trevor Manuel, a former finance minister of South Africa, and Grigoriy Marchenko, the central bank governor of Kazakhstan. So far, none has gained traction, while European leaders have rallied around Lagarde, 55, who announced her candidacy in Paris on May 25. "She has what it takes," British Prime Minister David Cameron said on May 27.

People take note when Lagarde walks into a room. At six feet tall, she's an imposing figure who favors well-cut suits, speaks perfect English, and boasts negotiating skills honed during 24 years as a corporate lawyer, six of them as chairman of Baker & McKenzie, an international law firm, in Chicago. Sometimes she can be glimpsed doing leg lifts and ankle flexes under the conference table, a reminder that she is a former champion synchronized swimmer who stays in shape by doing laps and yoga.

Lagarde has also proved that she can charm audiences beyond ministerial meeting rooms: In 2009 she appeared on Comedy Central's *The Daily Show*, where she donned a black beret and taught Jon Stewart how to pronounce *récession économique catastrophique*. Reflecting on her strengths as a negotiator last year, Lagarde said: "I'm not a threat, and I don't have a huge ego. And sometimes I can just break into laughter when something seems so serious and so tense, and I can just say, 'Holy cow, this is not a big deal.'" If she's the clear front-runner for the IMF job—and a welcome relief after the Strauss-Kahn scandal—the question remains whether she's the right person for it.

Potential Challengers for IMF Chief

Agustin Carstens	Trevor Manuel	Grigoriy Marchenko
Agustin Carstens Central Bank Governor Mexico University of Chicago-trained economist visited Brazil and India to promote his candidacy	**Trevor Manuel Former Finance Minister South Africa** Former anti-apartheid activist says the IMF job should not be reserved for Europeans	**Grigoriy Marchenko Central Bank Governor Kazakhstan** Leader of economic reforms at home, has said it's important to "get a representative from the emerging markets"
		

The IMF itself is under pressure to change. It has always been headed by a European, part of an unwritten agreement with the U.S. that lets the Americans name the president of the World Bank in exchange for leaving the IMF to the Old World. Over the past two years, as the fund has focused increasingly on European economic crises, Brazil, Russia, India, China, and South Africa have increased their financial support for the institution and want a greater share of voting power. Leaders of some countries, including South Africa and Mexico, argue that the next IMF chief should come from a developing economy.

Lagarde has been jetting around the globe in an effort to defuse such complaints. After lunching on salmon and capers with government officials in Brasilia on May 31, she promised to give developing nations more influence within the IMF; on a June 7 trip to India, she said she would consider naming a top deputy from one of them. The Indians weren't convinced, though, and Lagarde left the country without securing their support before she departed for China.

Another critique of Lagarde's candidacy is that the euro rescue deal she brokered didn't work out very well. Greece is still in crisis, with the prospect of default reemerging in recent weeks as ratings agencies have downgraded its sovereign debt. The IMF and European leaders are discussing whether Greece has made enough progress on austerity measures over the past year to deserve more aid. Simon Johnson, who was the IMF's chief economist in 2007 and 2008, says the euro zone leaders just "papered over the cracks" in the currency union, rather than finding a lasting solution such as a two-tiered euro zone in which stronger economies would not step in to prevent weaker ones from defaulting on sovereign debt. Lagarde's point of view, Johnson says, was "'Let's do a full bailout, let's protect the creditors,'" since French banks are among the most exposed to Greek debt. "That's a big conflict of interest."

If she has a broader vision for the IMF—beyond promising that Greek debt restructuring is "off the table" and that emerging markets will get more clout in the institution—Lagarde hasn't revealed it. Her tenure as France's finance minister offers few clues about her thinking, in part because economic policy was typically set by President Nicolas Sarkozy. And while Lagarde was pivotal in negotiating last year's euro rescue, she didn't design it: The idea for the bailout fund came from a Dutch Finance Ministry official named Maarten Verwey. She's not even an economist, although the IMF previously had one noneconomist chief, Ivar Rooth of Sweden, in the 1950s, and has plenty of smart economists to advise her. But even this backstop has its limits. "You cannot ask staff to make decisions for you. It is a hierarchical organization," says Raghuram G. Rajan, who was the IMF's chief economist from 2003 through 2006. "The top is expected to have a point of view."

If she gets the IMF post, Lagarde will be running an institution that is not only changing but changing fast. For decades the IMF dealt mainly with economic emergencies in countries such as Argentina and Turkey, dispensing loans in exchange for painful austerity measures such as cutting government jobs and increasing taxes. But after the financial meltdown of 2008, the 65-year-old institution started getting urgent calls from Europe—initially from the likes of Latvia and Romania, then, last year, from Greece, Ireland, and Portugal. The countries that finance the IMF agreed to triple its budget and assigned it a host of new missions. Strauss-Kahn, himself

PREVIOUS PAGE: LIONEL CHARRIER/ MYOP; THIS SPREAD, FROM TOP: NICHOLAS KAMM/AFP/GETTY IMAGES; BLOOMBERG (3)

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▲ A vote for Lagarde is a vote for the IMF to continue as it did under Strauss-Kahn (above, with Lagarde): gradually giving more power to emerging markets while pouring aid into Europe

a former French finance minister, said the IMF would provide about one-third of any bailout money needed in Europe to stem debt contagion—a pledge that some on the institution's board of directors saw as overstepping its role. "The agenda now at the IMF is Western Europe," says Marc Chandler, chief currency strategist at Brown Brothers Harriman in New York. "And it's partly out of their control," because some traditional IMF enforcement tools, such as currency devaluation, can't be used in euro zone countries.

Lagarde has won praise for steering France through the financial crisis, notably by dispensing $48 billion in aid to French banks, which are repaying the money with interest after stabilizing themselves. She also fought successfully to provide corporate tax relief, aid to small businesses, and tax credits to stimulate research. "None of those things would have happened without Christine Lagarde," says Frédéric Gonand, an economics professor at Paris-Dauphine University who recently stepped down after four years as Lagarde's chief economic adviser. "She placed her own mark on economic policy." A May poll by Ipsos for the magazine *Le Point* put her approval rating at 51 percent, far above her boss Sarkozy's 37 percent.

Still, France has fallen behind Germany in making the kinds of changes that could give the economy a serious boost, such as reducing government bureaucracy and labor market restrictions. The need to carry out policies dictated by Sarkozy has also put her in awkward situations at times. In 2009 she had to defend his plan to invest $51 billion in research and development and other projects at a time when France was under attack by other euro zone countries for running a 7.5 percent budget deficit, far above the 3 percent that member countries had agreed on. And despite her role in negotiating the euro rescue package, the terms of that deal, such as automatic sanctions against aid recipients if they didn't meet agreed-upon targets, were dictated largely by Germany. "France's game seemed to be, 'Let's stick to the Germans as closely as possible,'" says Philip Whyte, a senior research fellow at the London-based Centre for European Reform. "She's a great facilitator and chair, but she's probably not in the absolute center of influence."

Lagarde was raised in the Normandy port city of Le Havre, where her parents were teachers. She received her first exposure to the U.S. in high school when she was an exchange student in the Washington suburbs and interned on Capitol Hill. After returning to Paris, she failed the entrance exam twice for the Ecole Nationale d'Administration, a top finishing school for the French elite, before she enrolled in law school. She then joined the Paris office of Baker & McKenzie. After shuttling between Paris and Chicago for years, in 1999 she became the firm's global managing partner, overseeing more than 3,400 lawyers. She lived full-time in Chicago until 2005.

Few government officials anywhere outside the U.S. share her level of comfort with American culture and business. That was underscored in early May, when Sarkozy put on a digital economy conference in Paris just as Lagarde's name had surfaced as a possible replacement for Strauss-Kahn. Gliding into the conference in a trim black suit, her sculpted cap of white hair set off by a glowing tan, Lagarde was mobbed by French admirers before mounting the dais, where she was warmly greeted by the chief executives of Google and EBay. She even figured—sort of—in the recent Home Box Office film *Too Big to Fail*, in which actress Laila Robins portrays Lagarde blasting then-Treasury Secretary Henry M. Paulson for letting Lehman Brothers collapse. "You allowed it to fail, Hank. It was a horrifying mistake," her character says.

At a Group of 20 finance ministers' meeting in Paris in February, Lagarde was instrumental in bringing China into agreement on a plan to craft an early warning system for trade imbalances and other factors that could jeopardize global stability. China had resisted the idea for fear it would be used to push for revaluation of the yuan. But Lagarde, through the diplomatic serving of tea and *macarons*, offered concessions to Chinese officials that persuaded them to drop their opposition. "She clearly comes across as a leader," says Clay Lowery, a former Assistant U.S. Treasury Secretary who regularly saw Lagarde in action. "She's very talented and has an ability to work among finance ministers and heads of state." In March 2009 she helped cut short a European finance ministers' debate on reducing value-added taxes by advising the Czech Republic's Miroslav Kalousek, who was chairing the session, to delay the lunch break and shoo all the technical experts out of the room. The ministers soon got hungry and quickly worked out a deal on the issue, which had been under discussion for years.

Even some leaders of developing economies say it would be tough to find a better candidate than Lagarde. "We're in the strange situation of having another European in line for this job, but a European whose personal and professional qualities make her almost impossible to compete with," Russian Deputy Finance Minister Sergei Storchak says. The U.S. hasn't formally endorsed any candidate, but it's unlikely to oppose her.

If chosen, Lagarde would be the first woman to head the IMF, and her talent for low-key consensus building could bring a new style to the institution. She's not a protégé of Strauss-Kahn, who had been expected to run next year as the French Socialist Party presidential candidate against her boss, Sarkozy. Yet a vote for Lagarde is a vote for the IMF to continue what it did under Strauss-Kahn: gradually giving more voting power to emerging markets while pouring lots of aid into Europe. Her standing as the status quo candidate was underscored by German Chancellor Angela Merkel's remark that Lagarde could move "seamlessly" into the IMF post. Assuming she gets it, she might represent the sunset of the longtime transatlantic pact over IMF and World Bank leadership between the Americans and the Europeans. "My sense is," says Chandler of Brown Brothers Harriman, "Lagarde will probably be the last of the European claims on this job." B

—With Mark Deen, Rebecca Christie, and Sandrine Rastello

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NOT

The Mississippi flood of 2011 is not over. The most dangerous time is right now, when Baton Rouge and New Orleans are one breached levee away from Katrina-like devastation

WorldMags



AGAIN

By Peter Heller
Photographs by Franco Pagetti

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ON

May 20, a few minutes before 1 p.m. and a few miles above the Port of Baton Rouge, the towing vessel *Crimson Gem* was pushing 20 barges loaded with corn into a tight bend on the Mississippi called Wilkinson Point. The river was raging at eight knots, or about nine miles per hour. It creamed and ripped against pilings and tore along the wharves with a low hiss. Sheets of surface current collided and whirlpools seven yards across spun down the seams. Two days before, at this spot, the Mississippi hit 47.5 feet, the highest level ever measured here. In recorded history.

The captain wasn't thinking about flood records. He was running downstream and had all of his attention on setting up for a tricky right turn. He had to be moving faster than the river, but not too much faster. He didn't make it. The *Crimson Gem* got shoved to the outside of the bend, to the east, or left, bank and one of his lead barges collided with a barge being loaded with sulfuric acid at the Rhodia Dock.

As the captain frantically attempted to pull his load back toward the center of the river, cables snapped and four barges cut loose. Three of them sank. The fourth went careening toward the Highway 190 Bridge. The barge's gross weight, with load, was approximately 2,500 tons. It narrowly missed the bridge's east pier before it was corralled by some fast-acting assist boats. Because of the incident, the U.S. Coast Guard launched an investigation (refusing to release the captain's name) and closed up to nine miles of river for four days, breaking a critical link between the ports of the lower Mississippi River and all domestic navigation from the country's heartland. An official at the Port of New Orleans estimated that the blockade could cost the U.S. economy $100 million per day in lost commerce.

For some, lost revenue was a secondary concern: The flood of 2011 had, a week before, exceeded Project Flood, the U.S. Army Corps of Engineers' term for the maximum flows the entire Lower Mississippi flood control system was designed to handle. And while the natural crest was continuing to move downstream into the Atchafalaya River basin, the height of the water up and down the Mississippi wasn't dropping in a significant way. One terrifying scenario: a loose barge barreling toward the bank like a slow-motion bomb and notching or shearing the top off a levee already tested to its limit. What everybody knows, up and down the river, is that another levee breach, either at Baton Rouge or just above New Orleans, could cause Katrina-like devastation.

Colonel Edward R. Fleming, the Army Corps commander for the New Orleans District, which oversees flood control on the Lower Mississippi, is the man trying to manage the chaos. A West Point graduate, he has a master's degree in environmental engineering, wears camo fatigues, and carries folded in his breast pocket a sheet of the record-breaking stage levels up and down the river to remind him of the historic nature of this event, and of his responsibility. "The system has operated as it was designed to operate," he said on May 26. "We still have more capacity and flexibility built into the system.... I'm sitting on the edge of my seat. That's what I get paid to do." He added that the latest forecast showed the high water staying around until June 18 and then subsiding slowly as hurricane season arrived. "It's going to be a long summer."

**In the weeks leading up to the *Crimson* ***Gem* accident, flooding on the Mississippi caught the country's attention. The navigable waters of the Mississippi reach up like a branching tree into 31 states and drain 41 percent of the continental U.S., including cities from Pittsburgh to Taos, N.M., to Billings, Mont. The river serves as a transportation conduit between the nation's agricultural and manufacturing heartland and the rest of the world, while its water roads reach 60 percent of the American consuming public. The five-port complex between New Orleans and Baton Rouge 130 miles upstream is the third largest in the world behind Shanghai and Singapore, handling 475 million tons of cargo per year.

Deep-draft vessels—those with a hull deeper than a barge—cannot pass above Baton Rouge, so what they carry—chemicals, steel, and raw materials for manufacturing, largely—is transferred onto the empty barges for the trip upstream. It's an extremely efficient system: One 30-barge tow of grain powered by a single towboat carries the equivalent of 1,800 trucks, or 450 rail cars. An analysis of the 12-day closure of the Port of New Orleans during Katrina found that it cost the U.S. economy $295 million per day.

In the second half of April, snow melt in the upper Midwest and a freight train of wet low-pressure systems that dropped one to two feet of rain on already saturated ground in the Ohio Valley and across the Midwest swelled the river. It barreled toward Cairo, Ill., which sits at the confluence of the Ohio River, and on May 2 broke the previous record for stage level by over two feet. In a bid to save the town and relieve pressure on the river, the Army Corps of Engineers blew the levee at Birds Point, Mo. It was a "fuse plug" levee, designed for exactly this. It worked: Cairo was saved, 130,000 acres of Missouri farmland were flooded, and the river charged on without any appreciable drop.

The crest surged through Memphis, causing an estimated $320 million in damage and wreaking over $500 million of damage to farmland in Arkansas, according to the state's farm bureau. At one point it was estimated that one million acres of farmland were inundated in Arkansas alone. It barreled south to Vicksburg, Miss., overtopped the levees, and forced the Yazoo River to flow backwards for three days. Some 2,000 homes were flooded.

The Big Easy, which many inhabitants felt was just getting back on its feet, seemed

By one analysis, the 12-day closure of the Port of New Orleans during Katrina cost the American economy $295 million per day

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In May, the Army Corps inundated the Atchafalaya Basin to spare Louisiana cities

again like the Big Target. Would the Corps of Engineers' levee system, which had failed so catastrophically just six years before, protect them from the onslaught of a river that had never been this high? Would the spots where the dirt embankments are seeping or showing sand boils—places where water flows underneath—stand up to weeks of water three feet from their tops? A system of control structures and spillways, much of which was constructed over half a century ago, is the Army Corps' last resort in diverting water from the main stem of the river before it hits Baton Rouge and New Orleans. Will they continue to work?

Inside the operations room of the Corps' district headquarters in New Orleans, Colonel Fleming's Flood Fight Team keeps a careful eye on the map of potential trouble spots. Narrow daggers pinpoint each observed seep and boil in the levees. It looks like a porcupine. In all, there are 294 spots identified where the levees aren't completely holding water. Fleming's spokesman Ricky Boyett says, "Seepage is a common issue with an earthen levee system. We prioritize and monitor them. Seepage in itself is not necessarily detrimental to the stability of the levee." He adds that Duncan Point, below Baton Rouge, is one area of concern that is being closely monitored.

Fleming affirms, "Every foot of every levee is visually checked every day."

How many feet is that?

"Nine hundred, seventy-three miles."

A number of people, including Ivor van Heerden, whose analysis of levee weaknesses went unheeded before Hurricane Katrina, aren't so confident that Colonel Fleming's monitoring system will be enough to avert calamity. One of Louisiana's most respected hydrologists and a former deputy director of the Louisiana Hurricane Center at Louisiana State University, van Heerden is a trim, curly-haired, 60-year-old South African who loves, and fears, water. He once sailed his own 32-foot yacht from Cape Town to Louisiana, and he and his wife are restoring another from the bare bulkheads up for a cruise around the world next fall.

In 2001, van Heerden co-wrote a report published through the Center for the Study of Public Health Impacts of Hurricanes, which he directed at the time. His researchers used LIDAR remote sensing technology to measure the levees and found numerous discrepancies between heights claimed by the Corps of Engineers and actual readings on the ground. He posited some terrible scenarios of what could happen if the levees fail. Harold Schoeffler of Lafayette, La., president of the Acadiana chapter of the Sierra Club and a longtime student of water management on the Lower Mississippi, says, "The report reads like a blow-by-blow description of Katrina. Published five years before. Man, it was eerie."

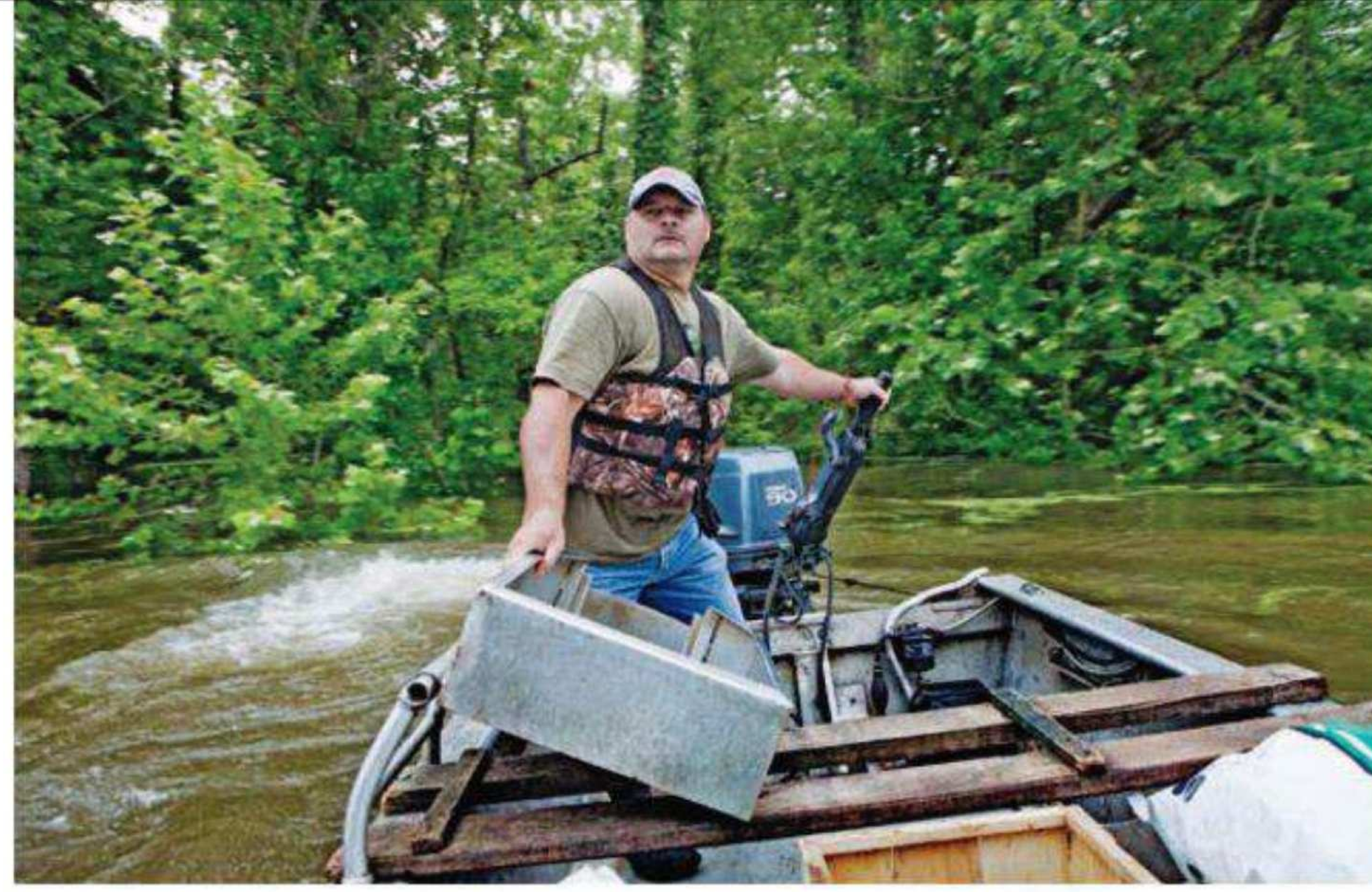
Van Heerden says the most dangerous time for a breach is in the weeks ahead, and that with most of the flood control system so old, nobody really knows the level of protection. "The weeks of water build pressure inside the levees. There are over 100 seeps and we know there are places with water pouring underneath. The most dangerous thing is if the water drops suddenly. The internal pressure is then pushing against nothing but air and it can blow out a levee. Then if the water rises again, you have a big problem. If a mainline river levee goes, that's going to be a Katrina-like event."

It's remarkable, given the consequences of the last flood of this magnitude on the Mississippi—the Flood of 1927—that in 2011 only four people

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The Morganza spillway was designed as a safety valve for levees downstream



Crawfisherman Jody Meche struggles to keep the lines of his traps above the waterline

have died and that property damage has not been far worse. John Michael Riley, an agricultural economist at Mississippi State University, estimates that total agricultural damage in all states affected may reach $1.5 billion. Few people, especially in southern Louisiana, like to praise the Army Corps of Engineers, but throughout the region the Corps is garnering grudging respect for handling a flood that is quietly making history.

In '27, the raging river stampeded downstream, overwhelming banks, bursting earthen levees, and wreaking havoc from Pennsylvania to the Mississippi Delta. When it was all over, water that had come from Canada and Montana, from Illinois and Minnesota and Iowa, lay in malevolent gray sheets over 27,000 square miles in 10 states. Over 300 were killed; 700,000 people were left homeless.

John M. Barry, in his authoritative book on the '27 flood, *The Rising Tide*, writes that the suffering caused by that flood led to the idea that the federal government should take some responsibility for its citizens in distress. It also prompted the 1928 Flood Control Act, which put in place the lion's share of the levee and flood control system in use today, and established Project Flood, the highest level it was designed to handle—equivalent to the 1927 flows plus 20%.

One critical piece of the system is the Atchafalaya River and its two mammoth control structures. Some 50 miles above Baton Rouge, the Atchafalaya takes its water from the Red River and from the Mississippi. It can take a lot of water. In fact, it acts like a western fork of the bigger river—a more efficient fork, even. According to the Corps, it reaches the Gulf of Mexico in 100 to 150 fewer river miles than the main stem, and has a steeper gradient. If water can be said to want anything, the Mississippi River water wants to go there, and the Corps



Colonel Fleming of the Army Corps of Engineers made the call to open the spillway

had to build a marvel of engineering called the Old River Control Structure in 1963 to keep it from jumping into Atchafalaya's bed, draining the Mississippi, and leaving the Port of New Orleans high and dry.

Before that, however, in 1954, the Corps of Engineers constructed a spillway at the town of Morganza, La., 35 miles below the Old River Control and 50 miles above Baton Rouge, to save New Orleans from an opposite, wetter fate. This spillway allows the Corps to siphon off water from the Mississippi and into the Atchafalaya in case of emergencies. The idea was to create a way to relieve pressure on the main stem like the blown levee way up at Birds Point, but without the dynamite.

Colonel Fleming explained that the trigger for opening the gates of this spillway was reaching Project Flood: 1.5 million cubic feet per second (cfs) on the Mississippi at Morganza. It had only happened once, 38 years ago. On May 14, General Michael J. Walsh, commander of the Mississippi Valley Div. of the Army Corps of Engineers, ordered the gates to be opened again.

Jody Meche is half throttle at 20 knots, running his 19-foot aluminum skiff down a twisted trail of water in the Atchafalaya Basin, which is bring fed from the Morganza Spillway. The boat responds like an animal, finding impossible openings in a thick forest of cypress and tupelo, purple flowering floating lilies, and birds. Ibises and egrets, startling white, fly out of the canopy. Squadrons of yellow-crowned night herons, in ragged V's, skim broadwinged just over the treetops. Near the hamlet of Butte LaRose, the treetops aren't very high up: Meche is used to fishing these bayous and sloughs in three to six feet of water. Since the Corps opened the Morganza and raised the stage level to 23 feet, he looks down at heron's nests, at water level, that should be way up in the trees.

"I don't like that the animals get hurt," he says, cutting the engine. "The birds have a natural instinct. They're not programmed in accordance with how the Corps is managing the water. The other day I saw two little armadillos on a log. They didn't have nowhere to

Are the Dakotas Next?

On June 7, river gauges throughout the U.S. remained at or above flood levels, with tributaries, the Missouri River, and upper Mississippi vulnerable to destructive flooding. Until June 12, the National Weather Service warned that some Dakotans may have to evacuate

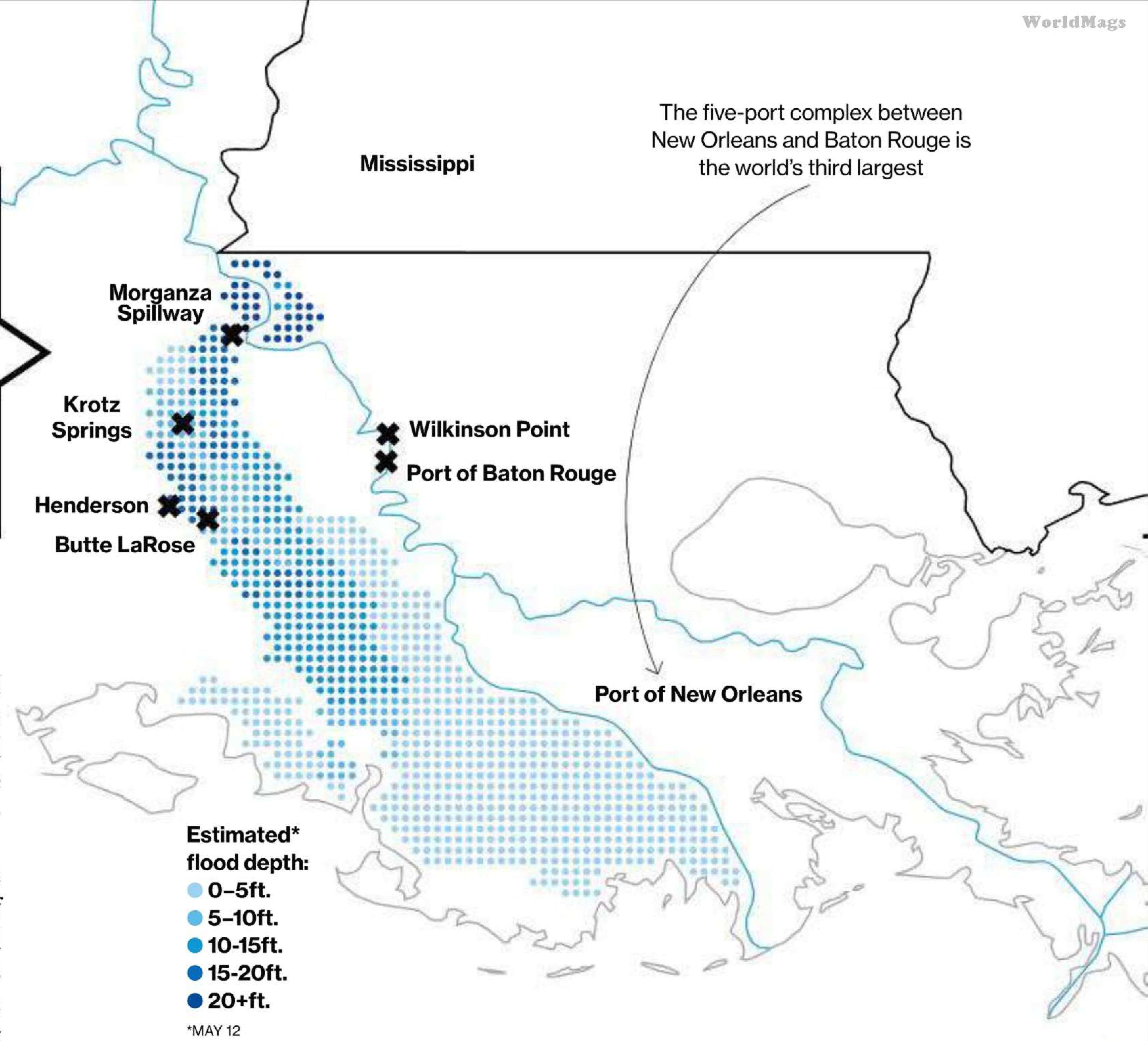


As many as 1 million acres of Arkansas farmland are underwater

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Project Flood

Heavy rains and melting snow fed a flow of 1.5 million cubic feet per second of water at the Morganza spillway this spring. To avert a disaster downstream, the Corps of Engineers opened floodgates at the Morganza, inundating the Atchafalaya basin. So far the diversion has worked

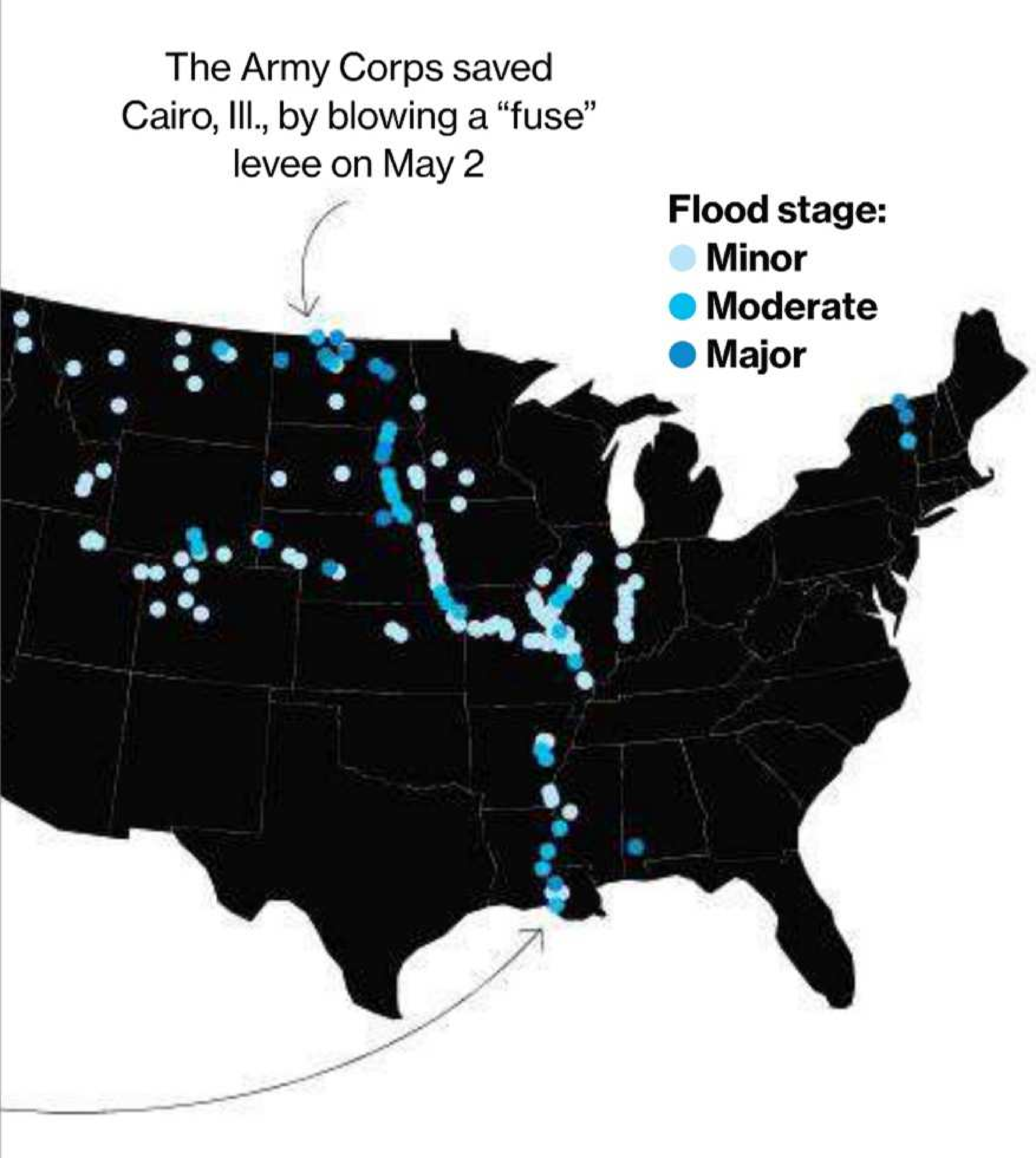


DATA: ARMY CORP OF ENGINEERS, NATIONAL WEATHER SERVICE

go. And a rabbit. He jumped off when I came. Swimming." Meche says the gators eat the small animals like popcorn, and the snakes go up in the trees and eat the birds. "It's almost like the Corps is playing God," he says.

The Atchafalaya Basin, fed by its namesake river, is 800,000 acres of iconic moss-hung cypress swamp and lily-choked bayous and lakes; it's his office and his cafeteria. Meche, 41, is Cajun. He speaks with a French accent and loves crawfish. In a normal season, he runs 800 crawfish traps–400 every other day. Now he has to run half that because the strong current loosed from the Morganza shoves his boat around and tangles traps. "For years," he says, "they don't give us enough water. The water pockets up, loses oxygen. The crawfish die in their traps. Dead water everywhere. Now this."

The Basin, like the rest of the Atchafalaya riverway, is confined between lines of north-south levees that run from the Old River Control Structure to just above the river's delta at the Gulf of Mexico. Unlike its sister river off to the east, the Mississippi, the Atchafalaya has guide levees that are mostly 18 to 20 miles apart. It creates a huge catchment of swamp and lakes that fills slowly, and empties slowly. Two small towns lie within the Basin, between the levees. And one prosperous port town sits at the bottom of the floodway, catching the brunt of the diverted flow just before the river empties itself into the sea.



If Meche is mad, it's nothing like the fury of the folks over at Butte LaRose. Nobody likes to be flooded on purpose. On the evening before a mandatory evacuation on May 24, Doucet's grocery store was empty. The fish camps and houses along the blackwater bayou were empty. No cars in the driveways. No sound but loud frogs, the croak of a heron, the peeps of purple martins wheeling in a sky fading to lilac. Water was already reaching up into some of the yards. A single National Guard Humvee drove lights-on up the only road. It felt like the apocalypse.

In a town of 1,400, there were now seven people. Two were Anthony and Betty Ardoin. Willy, a Great Pyrenees rescued from Katrina, was already loaded in the truck. As it got dark the couple was tying their lawn furniture to trees, taking a last look around. Betty fought back tears, pointed to a line drawn on the side of her house at about waist level.

"This is 24½ feet on the gauge marked here. That's the new estimate. That Colonel Fleming, he came to the firehouse, said the water was going to be 15 feet higher than where we were standing: 15 feet!" She grabbed a wood pole, stuck the end up against a second story window. "That's up here. We moved everything up. People cried and crossed themselves. He terrified folks. He shouldn't have done that. How could they be that far off?"

Another resident about to leave was Jack Domingue, white-haired and a little stiff, who carried a jug of sugar water and filled up the 16 hummingbird feeders hanging from the roof of his patio. "All these'll last about six days. I don't know when I'll be back." He stood on the concrete in the half dark. "Stand real still. They'll come in." In a minute, with the dark water rising a few feet away, the old man was surrounded by the hum and whip of a hundred tiny wings.

Louisiana loses 25 to 35 square miles of land per year to coastal erosion, according to the state. Scientists say that this is because the very levee system designed to protect its population is funneling the Mississippi through earth and concrete walls all the way to the continental shelf, where its rich sediment load is dropped into deep water and has no chance of contributing to the natural processes of coastal rebuilding. This, in turn, contributes to the damage caused

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A partially submerged home in Butte LaRose, La., after the spillway was opened

by hurricanes and storms: The marsh and barrier islands that protected coastal towns are disappearing.

It drives people like G. Paul Kemp wild. He's the vice-president and director of the National Audubon Society's Gulf Coast Initiative and another respected hydrologist. He worked with van Heerden on the study that warned of a disaster like Katrina, and when the BP oil spill hit the coast, he and van Heerden urged the state of Louisiana and the Corps to open diversions, siphons, and locks to push water into the Gulf and keep the oil offshore. "They could have done 50 years of coastal restoration with this one flood. We built two spillways at a cost of $100 million, just to distribute sediment into the marshes, and they didn't use them." says Kemp. "We had a perfect opportunity to prove that it works."

Kemp is also concerned about the state of the current levee system and the weeks of high water ahead. "We are seeing stage levels get higher over the years with the same amount of volume in the river." That points to an obvious conclusion: The levees need to be raised.

Gary P. LaGrange, on the other hand, is silt's sworn enemy. He's the president and chief executive officer of the Port of New Orleans. He's a local boy—now a very big 65-year-old man in a pinstriped suit, shot cuffs, and cream shirt—from the little town of Franklin. He studied geography, so he knows the importance of sediment to the coast, but he doesn't want it in his river channel.

LaGrange played valve trombone in a blues band, got a master's in urban planning from the University of Louisiana at Lafayette, and was teaching there when he got a call from the newly formed Port Commission for the Port of West of St. Mary. They wanted him to be their port director. Problem was, there was no port. Not yet. "We obtained a cane field on the river. In the beginning we were crawling through barbed wire and cane with machetes." It took a while, but his new port went international soon enough, receiving cargo in ships from Costa Rica. "I guess we built that port from the weeds up." He moved on to direct the Port of South Louisiana and the Port of Gulfport before coming to New Orleans.

He's amazed at the skill of the Army Corps of Engineers. "I'm telling you, they operate the gates—it's almost musical in the way they operate them." He grins. "Like a valve trombone." He says the Corps called him when the crest was coming down the river and said, "Gary, don't worry. It'll stay at 17 feet in the port." Fleming explained that they could promise that because they had opened the gates of the Bonnet Carré Spillway, another pressure valve just above New Orleans.

"All that water is bringing a whole lot of sediment," LaGrange says. "When it starts falling, the sediment will drop out." He says the Lower Mississippi has a design channel depth of 45 feet. "The last five years, the cost of dredging the Lower Mississippi River is $104 million. On an average, Congress and the Administration have appropriated $55 million to $65 million." He explains that previously, when it ran out of funds in September, the Corps would "reprogram" funds from districts that had a surplus, and they would make their depth. "We received an announcement that this year they would no longer reprogram funds. Now, with the higher rivers, the shipping industry has projected that that shortfall will be $95 million."

He leaned forward in his chair. "Every foot in lost depth costs the economy $1 million per ship call," says LaGrange, because ships have to carry lighter loads. Less cargo equals less production. "We have 12,000 ship calls per year."

That's $12 billion per annum. "And we need $95 million." He thinks the government should find the money.

The first of June marked the official start to hurricane season, and the prospect of more water makes van Heerden wary. "It's not inconceivable that we could get an early tropical storm that dumps 30 inches of rain on Louisiana," he says, looking grim. "The Army Corps of Engineers has claimed on numerous occasions a 1-in-1,500-year level of protection. This is a one-in-25-year event, and it is completely challenging the system. You have citizens and the National Guard mobilizing to sink barges in bayous and fortify levees. It raises the question: What level of protection is the Corps really offering?"

Van Heerden has called for a complete overhaul: a gathering together of independent scientists, engineers, and social policy experts to reexamine the entire Mississippi flood control system. He points out that it would have cost $400 million to fix the levee system around New Orleans before Katrina and that, instead, 1,700 people died and it cost upward of $200 billion to repair the damages after the fact.

Colonel Fleming doesn't disagree. "There's no doubt that after this event we will have to take a hard look at the entire system. We've now passed the Project Flood. We have passed what everybody thought would never occur. Do we have the system right?"

"For years, they don't give us enough water. The crawfish die in their traps.... Now this"

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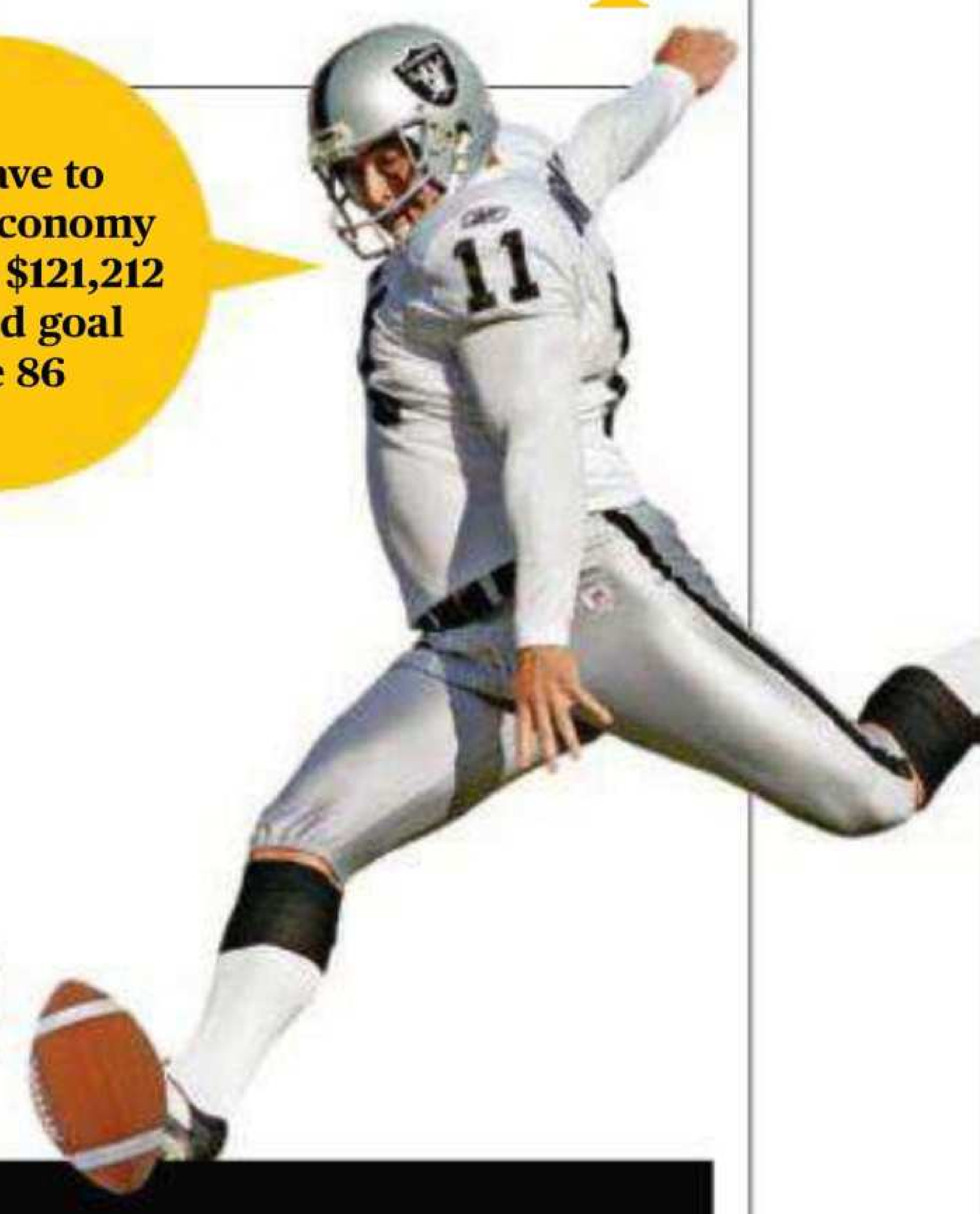
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You have to love an economy that pays $121,212 per field goal page 86





The Mafia Management Guru

Mobster Louis Ferrante shot people, went to jail, became a Jew, and then an author. Now he has a message for executives. *By Joel Stein*

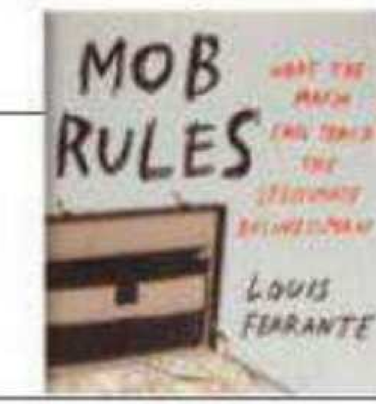
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Etc. The Mob

Chapters include: "Don't end up in the trunk of a car: Avoiding office politics"



The beeping in Louis Ferrante's borrowed Lincoln SUV won't stop, so he finally snaps in his seat belt. "Don't tell anyone," he says. "No self-respecting gangster ever wears his seat belt." Ferrante, who served eight and a half years in prison for crimes he committed as part of New York's Gambino family, believes the Mafia offers even more useful lessons than not wearing seat belts. His new book, *Mob Rules: What the Mafia Can Teach the Legitimate Businessman*, offers these primers in 88 succinct chapters. They include: "Don't end up in the trunk of a car: Avoiding office politics" and "It's good to go to a funeral as long as it's not yours: The power of networking."

In a nod to the management genre, Ferrante, 42, employs the case study method to go over decisions made by, among others, "Fat George" DiBello, "Fat Pete" Chiodo, and "Fat Tony" Salerno. *Mob Rules*, which draws heavily on history, begins with "In ancient Sparta" and goes on to recast complex events with insights such as "There was a wacko Roman emperor named Caligula, who whacked everyone." Nicholas Pileggi, who wrote the books that inspired the mob classics *Casino* and *Goodfellas* (and co-wrote the screenplays with Martin Scorsese), sees the utility of wiseguy wisdom. "I'm surprised at how some equity fund guys don't read the room," he says. "They could learn from Louis Ferrante. It doesn't hurt them. They wouldn't shoot anybody."

Ferrante, who stands just 5 feet 5 inches and has the darty energy of a Joe Pesci character, is certainly a qualified teacher. He started stealing car parts at 12, was running a Queens chop shop before he was old enough to drive, and eventually had his own crew. Now he's merely the latest mobbed-up entrepreneur trying to cash in on America's endless infatuation with *La Cosa Nostra*. After finishing a jail stint in 2003,

"In my world, I'm amazingly polished," says ex-mobster Ferrante

he quickly discovered that legitimate business wasn't his thing. "I can't sit somewhere every day. I still have the street in me. I need to be out," Ferrante says. "I found what I do good, which is write." He subsequently scored a $250,000 advance from HarperCollins to compose his 2008 memoir, *Unlocked: A Journey from Prison to Proust*, about how he read his first book in jail—and then read nearly the entire Western canon. In addition to promoting *Mob Rules*, Ferrante is currently working on an Edward Gibbon-style history of the Mafia and sniffing around for other media spinoffs. "I'm surprised I don't have a show," he says.

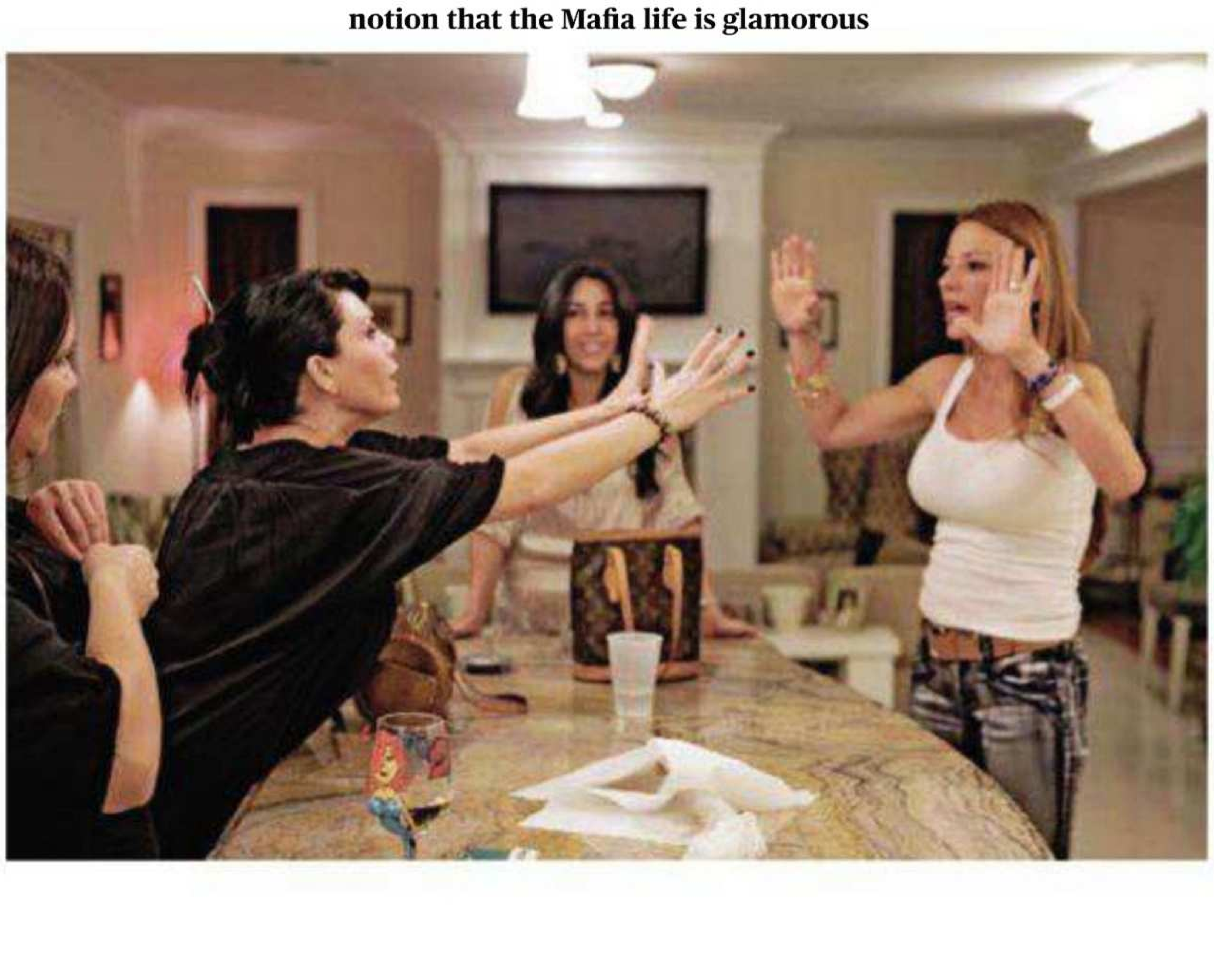
Regardless of whether he gets one, Ferrante is poised to profit from an iteration of the mob industrial complex that's far different from the one popularized by Pileggi and Scorsese in *Goodfellas*. In recent decades the Mafia's business model has stagnated: The big industries, such as garbage collection, have been replaced by smaller rackets such as phony car insurance claims. Along the way the business lost its clout. "When I went to court," remembers Ferrante, leaning against his borrowed SUV and smoking a Gurkha cigar, "I asked up in the family to see if we had anyone in the court system. We didn't. Maybe the building department or the DMV. That's all you get now." And with the loss of clout came the decline of standards. While other mobsters came to support him during his trial, Ferrante remembers being embarrassed by their wives. "They'd say, 'I told my wife to dress up,'" Ferrante recalls, "but she'd look like a five-dollar whore, wearing a tank top. This is the best you could do? Read a magazine!"

Sitting inside Francesca's, an Italian restaurant on Staten Island with a terrific cash-only offer on the menu, Ferrante admits that the mobsters he knew were always pretty tacky. "Even when I started, they weren't in three-piece suits anymore. They were wearing shorts and fat sneakers," he says. "You think a local politician is going to sit down with a guy now? They think they're buffoons. In my world, I'm amazingly polished. I'm like a f---ing aristocrat."

The good news for Ferrante is that the mob's tackiness might actually be its best business plan—especially when it comes to marketing books with 88 chapters. In the *Jersey Shore* era, the public's somewhat incomprehensible appetite for trashy culture has given rise to a new Mafia economy. In addition to bronzer, velour jogging suits, and pinky rings, it includes Danny Provenzano, a nephew of the late North Jersey mobster Anthony "Tony Pro" Provenzano, who became a bit player on *The Real Housewives of New Jersey*; former Colombo family honcho Michael Franzese, the author of *I'll Make You an Offer You Can't Refuse: Insider Business Tips from a Former Mob Boss*; and the irrepressible sometimes-writer Victoria Gotti, the matriarch on A&E's now-defunct *Growing Up Gotti*.

These players are part of a larger market that thrives on the shortage of Corleone-esque glamour. Even the $25 million Las Vegas Mob Experience

VH1's *Mob Wives* disabuses viewers of the notion that the Mafia life is glamorous



museum at the Tropicana Hotel—home to historic artifacts such as the poem Meyer Lansky carried in his wallet—is cheesed up with actors in pinstriped suits handing out envelopes of fake cash to other actors in pinstriped suits. VH1's reality series *Mob Wives*—which follows a gaggle of deeply tanned Staten Island women as they make scary faces, put ice cubes in their wine, and talk about jailed family members—isn't helping, either. Perhaps the only appealing depiction of mob life presently in circulation is HBO's *Boardwalk Empire*—and it takes place in the '20s.

Over a kosher meal of sea bass, the restaurant's owner tells Ferrante that *Mob Wives* taped a scene in the restaurant a day earlier. The news prompts Ferrante, who converted to Judaism in prison, to declare that the Mafia lost its sheen when Gambino family underboss Sammy "The Bull" Gravano snitched on the family's don, John Gotti, in 1991. Fittingly, in the shorts and fat sneakers era, Gravano's daughter is now the star of *Mob Wives*.

These days, Ferrante is learning to embrace the less glamorous aspects of a post-Gotti age. Ferrante, who's engaged to a librarian, says the women who approach him in his new life as an author are "still intrigued by the mob s--t." More important, they're intrigued by how unglamorous the lifestyle seems. "Our viewers are glad to see that everything that glitters isn't gold," says Jennifer Graziano, daughter of jailed former Bonanno consigliere Anthony "The Little Guy" Graziano and the creator of *Mob Wives*, which was recently picked up for its second season.

That's the point. "It isn't glamorous. That's the message I'm trying to put out there," says co-star Karen Gravano, who spent three years on probation for being involved in a drug ring. "In the outside world, they think it's cool," says the daughter of Sammy "The Bull." "That everything is so glamorous. The movies portray it that way. Every time my father was on TV with John Gotti, I had more friends. It's not cool." Gravano is getting used to the fans who comment that her habits are un-Godfatherly. "I guess I'm not gangster because I put ice cubes in wine," she says.

Ferrante hopes to ride the ice-cube-and-wine wave by showing that being a mobster isn't all that different from being an office drone. In *Mob Rules*, he offers simple suggestions for building trust within an organization, delivering on promises, establishing corporate rules, and never, ever putting information in e-mail. He also offers easy-to-remember nuggets of management advice such as "On the way up, you can put up with a few farts, but never let anyone s--t on you." In the end, however, what may help Ferrante succeed in the new mob landscape is his ability to learn from his past. "I was in jail when I read that someone died after getting shot in the leg," he recalls. "I said, 'There's an artery in there? Holy s--t! I shot people in the leg all the time!'" **B**

ILLUSTRATIONS BY JOHNNY RYAN

How to Become a Fully Branded Celebrity Mobster

A step-by-step guide to turning a few silk suits into media gold



Knots Landing

Are you man enough for pink stripes? This summer's ties are all about textures, light colors, and preppy patterns



WorldMags

1. Alexander Olch English seersucker, 2.75 inches at widest point, $140, olch.com **2.** Thomas Pink pink-and-blue knit, 2.5 in., $105, thomaspink.com **3.** Vineyard Vines Thomas Stripe Woven, 3.5 in., $85, vineyardvines.com **4.** Vineyard Vines tennis print, 3.5 in., $75 **5.** Aubin & Wills striped silk, 2 in., $80, mrporter.com **6.** Tommy Hilfiger seersucker, 3.13 in., $49.50, tommy.com **7.** J. Crew chambray narrow, 2.5 in., $59.50, jcrew.com **8.** Salvatore Ferragamo elephant print, 3.25 in., $170, ferragamo.com **9.** Billy Reid knit, 2.25 in., $95, billyreid.com

—By Lauren Bernstein



PHOTOGRAPH BY NICK FERRARI FOR BLOOMBERG BUSINESSWEEK

WorldMags

Etc. Nation Branding

Europe's Bubble Gum Machine



Eurovision, the cheesy pop music competition, is now a rebranding platform. *By Peter Savodnik*

During the Cold War, the Eurovision Song Contest, like NATO and drum machines, was a strictly Western affair. The made-for-television fiesta featured international competition and a fireworks-laden final round. It drew tens of millions of viewers in Britain, France, West Germany, and Scandinavia, and launched superstars such as Julio Iglesias and ABBA.

Then, in 1989, the Berlin Wall collapsed, Europe became much bigger, and places like Serbia and Moldova started cranking out pop stars. This greatly expanded Eurovision's viewership and set the song contest on a new trajectory. The watershed moment came in 2001, when the hitherto little-known country of Estonia became the first post-Soviet republic to win the competition. Neighboring Latvia won in 2002; Ukraine, in 2004; Serbia, in 2007; and Russia in 2008. Last month, a country that many Eurovision aficionados believe isn't even in Europe—Azerbaijan—snagged first place in Düsseldorf with its moving ballad, *Running Scared*, which opens with the stanza: "Come to me, come to me tonight. Oh God, I need you."

"I think Azerbaijan, next year, will be an entirely different ballgame," says one Eurovision scholar

The Azeri victory is a sign that Eurovision has strayed irrevocably from its origins. When it was hatched in 1956, the song contest was supposed to be for dueling divas—male and female—from Western European countries, and these singer-representatives would battle it out for a night. Today, Eurovision has become a good platform for undeveloped countries riddled with rusting tractor factories, gold teeth, and unfiltered cigarettes to show that they are, in fact, modern—which is what you want to be if you're trying to lure investors and tourists. Winning Eurovision, after all, offers a country the chance to host the next year's contest, allowing the whole Continent to train its spotlight on some place it never thought about.

So far, it's worked. Irving Wolther, a self-described Eurovisionologist from Hanover, Germany, says Estonia's landmark victory has become the model for backwaters everywhere. "Estonian Television used the show for national branding, placing Estonia among the Scandinavian countries with impressions of pine forests, saunas, and Nordic clichés," he says. "This way they could free themselves from belonging to the post-Soviet sphere." Wolther says the economic benefit of Estonia's win is "up to $10 billion"—although he doesn't explain how.

Meanwhile, the Azeri government, run by strongman Ilham Aliyev, is looking to pump millions of dol-

GETTY IMAGES (10)



Azerbaijan: petro-state, Iran buddy, pop power



In 2006, Lordi confirmed suspicions that **Finns** should stick to elk hunting

Sertab Erener's *Everyway That I Can*, in 2003, tried to show that **Turkey** belongs in the EU

Norwegian Alexander Rybak, the 2009 winner, was born in Belarus. It was not unnoticed

Germany, in 2010, was the first founding member of Eurovision to win in two decades

lars into next year's contest. Paul Jordan, a PhD candidate in Central and East European Studies at the University of Glasgow, notes that the Russians spent nearly $30 million in 2009 and that the Azeris are already talking about spending more—even though their country is about 1/200th the size. "I think Azerbaijan, next year, will be an entirely different ballgame," says the aspiring Eurovisionologist. Moreover, notes Wolther, the oil-rich country's "will to use Eurovision as a platform for national-cultural representation is enormous." It better be: Azerbaijan has one good highway, connecting the airport and Baku, the capital, and just a few hotels and office towers. To convince outsiders it's a safe place to park capital, the country might have to raze some Soviet-era apartment blocks and do some touch-up work on the crumbling mosques that dot the cityscape.

They'll also have to block out criticism from many who can't quite believe Azerbaijan actually won. "I would like to stay politically correct," says Audrius Girzadas, a Lithuanian radio personality who led his country's delegation at Eurovision 2011, "but I would be very careful about calling Azerbaijan part of Europe." (John Loughlin, a political scientist at the University of Cambridge, believes Azerbaijan is European but only "in the elastic sense.") Sebastian Vinther, a guitarist for Denmark's 2011 entry, quips that the winning Azeri song, *Running Scared*, is "not much of an Azerbaijani song" since it was actually written by a Swedish composer. Others suggest that Azerbaijan triumphed only because the public casts half the votes via cell phone. If the juries—which control the other half and are said to have better taste in music—had their way, Italy, represented by the jazzy Raphael Gualazzi, probably would have won.

The contest's future may reside in making sure there are enough television sets on Belarusian farms

All agree, however, that what matters most are actually the dancers, the pyrotechnics—the nonmusical stuff. Even hapless boy bands such as Blue, which represented Great Britain this year, lacked the raw campiness to compete with rising powerhouses like Bosnia and Herzegovina, Georgia, and Ukraine. Some Western Europeans now get it. The Irish duo Jedward—aka the brothers John and Edward Grimes—performed a song titled *Lipstick*, which is about nothing, and talked about their hair, which is blond and one foot tall. "People say our hair is rock solid, but it's not," Jedward explains. "We're not contributing to global warming or anything."

Yet even Jedward couldn't stop the Azeris. Ell/Nikki—aka the Azeri duo that performed *Running Scared*—gave viewers what they wanted: a song they've heard countless times before wrapped in a dance and light show. Evelina Sašenko, who represented Lithuania at Eurovision 2011, claims the Azeris were not the most talented act at Düsseldorf. "Everyone noticed," she says. And it doesn't matter. "Eurovision is not only about delivering your best vocal performance."

What many post-Soviet nations have not noticed, however, is that they're increasingly competing with each other, not the Western Europeans they want to impress. John Kennedy O'Connor, author of *The Eurovision Song Contest: The Official History*, estimates that 90 percent of TV viewers in certain Eastern European countries watch Eurovision. Meanwhile, he says, "the West has become perhaps a bit sneering." Figures provided by the European Broadcasting Union, which produces Eurovision, support the theory: In 2011, 69 million people watched the Eurovision finals, down slightly from 73 million in 2009, when the event was hosted in Russia. By contrast, the 2010 competition, held in Oslo, was watched by only 60 million. Eurovision's future may reside not in luring back Western Europeans but in making sure there are enough television sets on Belarusian farms.

While it's to be expected that the French might look down on Eurovision, it's actually the Poles who show how much the contest has changed. Martin Plassowski, business development director at the advertising giant Saatchi & Saatchi's Warsaw office, says 2.3 million Polish viewers watched Eurovision in 2011, compared with 8.3 million in 2003. The "attractiveness of this pan-European event has faded," he says in an e-mail. "Now we have lots of attractive commercial events competing with Eurovision." Then he adds a sideways smiley face. **B**



Thankfully, Jedward's hair is not a threat to the environment

WorldMags

Etc. One True Thing



"Things get crazy as you get into your day," says Middleberg. "This will give you a ton of energy so you don't crash"

If you're feeling adventurous, replace the organic cereal with two tablespoons of chia seeds. This wonder food is packed with make-you-sharper omega-3s

The Desk Breakfast

The perfect cubicle-friendly, foodie-approved kick-starter

By Leslie Robarge

The Want: A healthy, desk-appropriate morning meal that doesn't look gross, smell gross, or scare your co-workers. It should also stop your stomach from growling during midmorning meetings.

The Get: "A yogurt parfait is the perfect power breakfast," says Stephanie Middleberg, a registered dietician in New York. Start with a seven-ounce container of 2 percent Greek yogurt. "Don't go with the nonfat," says Middleberg. "You need the protein." Mix in a quarter-cup of high-fiber organic cereal with less than five grams of sugar per serving. (Kashi Heart to Heart is a good option.) Add a piece of sliced fruit. Stir in a tablespoon of honey and a sprinkle of cinnamon. Ⓑ

THE BAR MINIMUM

Breakfast is a must—even in a hurry. Here are four legitimately healthy grab-and-go options.



Lärabars

You should be able to recognize all of a bar's ingredients. Lärabars are made from no more than nine whole foods (think almonds, bananas, coconuts)—and that's it.



Trader Joe's

Keep the "bad" saturated fat under 3 grams. Trader Joe's fig, strawberry, blueberry, and apple cereal bars, made from organic grains, all have zero grams of saturated fat.



Kind

Look for bars with three to four grams of fiber and less than 15 grams of sugar. The fiber-to-sugar ratios in nearly all varieties of Kind bars fit the bill.



Nature Valley

Avoid breakfast bars boosted with excessive amounts of protein. There are 2 grams of protein per Nature Valley Peanut Butter granola bar.

PARFAIT: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

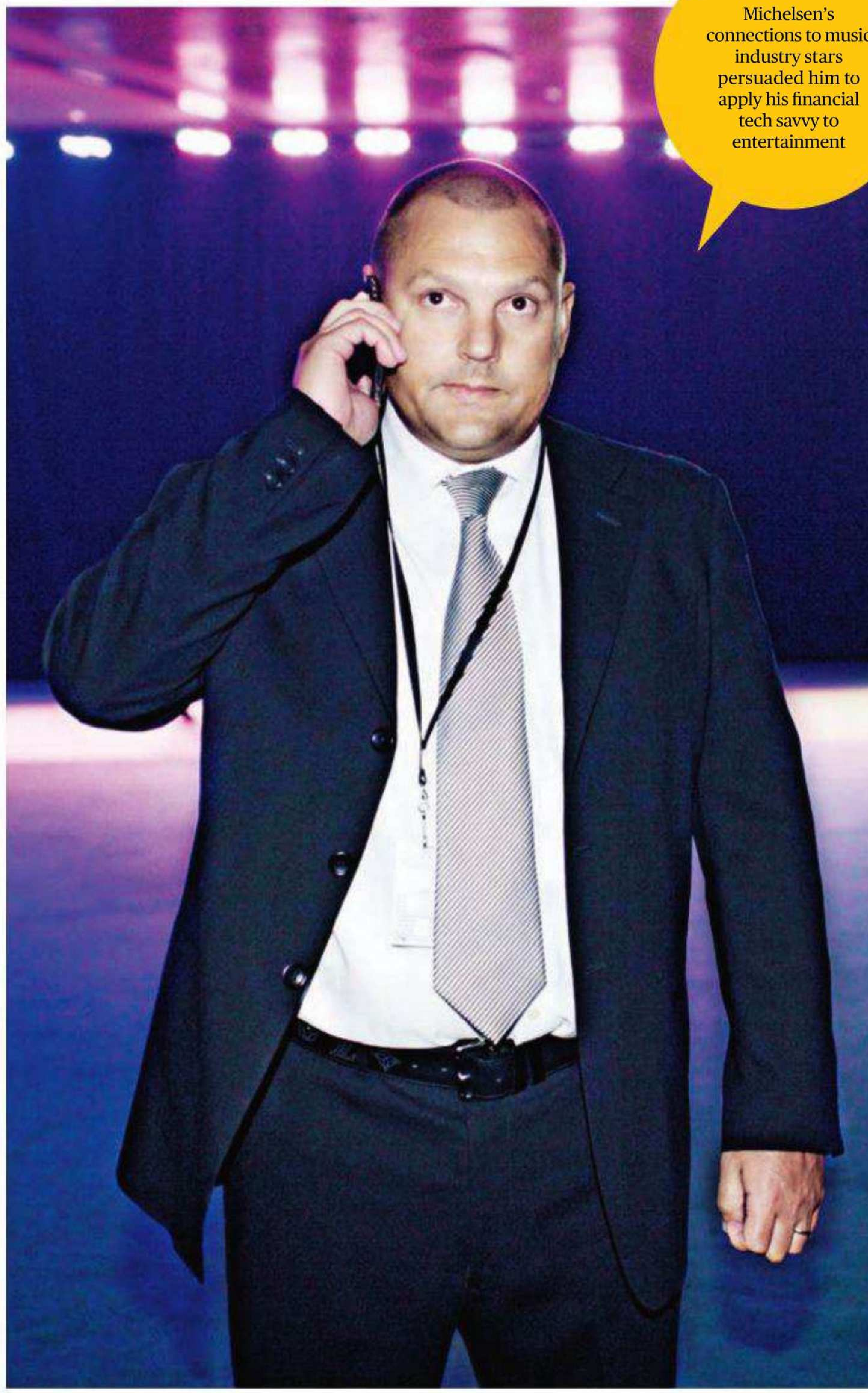
Etc. Next Life



Michelsen considers Lady Gaga a fifth co-founder of the Backplane

Reborn This Way

A former hedge fund manager finds his second act herding millions of Lady Gaga fans



Michelsen's connections to music industry stars persuaded him to apply his financial tech savvy to entertainment

In 2008, hedge fund manager Matthew Michelsen received the phone call that would change his life—from 50 Cent. Actually, the rapper and energy drink mogul was calling to speak with Michelsen's wife, Jenny, about investing in her 3D eyewear company, Gunnar Optiks. Jenny passed the phone to Matthew, and an unlikely friendship was born.

Michelsen, who co-founded trading technology firm UNX after starting two hedge funds, never thought he'd work in entertainment. Yet after "Fitty" introduced him to Lady Gaga's manager, Troy Carter, Michelsen saw an opportunity to employ his financial tech expertise: Carter had been looking for a way to unify Gaga's "Little Monster" fans online. Michelsen, now 39, introduced Carter to Silicon Valley entrepreneurs Joe Lonsdale and Alex Moore. The group subsequently founded the Backplane, an online platform that allows fans to build all-encompassing e-communities. Michelsen left UNX in 2010.

With seven figures in startup costs coming out of Michelsen's pocket, the Palo Alto company has 12 employees, and, he says, is in talks with Eminem, Justin Bieber, and the National Football League. Its most important client, however, remains Gaga. Littlemonsters.com uses the Backplane technology to create a Gaga universe for her 38 million Facebook fans and 10 million Twitter followers—replete with e-mail addresses and calendars. "The goal is for everyone to start their own interactive community," says Michelsen. "If you're a Girl Scout mom, you could have your own Backplane with 12 other moms." Though the Gaga model seems a bit more promising. Ⓑ —*Alexandra Wolfe*

MICHELSEN'S BEST ADVICE

1. Know your weaknesses

"Find friends and business partners who can do the things you can't. This is hard to do, because most people only really value the skills they're good at and downplay the importance of other abilities."

2. Exude confidence

"It's contagious. Walk into rooms planning to make it happen. If you assume something is impossible, it probably is. But if you're confident that you're supposed to be there, others will be, too."

MICHELSEN: PHOTOGRAPH BY MICHAEL EDWARDS FOR BLOOMBERG BUSINESSWEEK; LADY GAGA: RONALDO SCHEMIDT/AFP/GETTY IMAGES

WorldMags



The $145 Million Fastball

Understanding the booming, illogical relief pitcher economy

By Roger Lowenstein

The aphorism "You manage what you measure" can explain a great deal of the world's foolish behavior. The corporate chief executive who tries to kowtow to Wall Street rather than attend to business is, after all, simply enhancing his company's stock price—which is what we measure. While reading Charley Rosen's *Bullpen Diaries,* it occurred to me that the adage might even explain baseball. In what sounds like a dream job, Rosen watched every pitch of the New York Yankees' 2010 season, but his focus is the bullpen. And within that, his prime subject is the Yankees' incomparable closer, Mariano Rivera.

Rivera, the son of a Panamanian fisherman, was already 20 years old when he signed with the Yankees for a paltry $3,500 in 1990. He did not reach the majors until he was 25; the next year, 1996, his career turned with the almost accidental development of an unhittable pitch. Rivera's fastball, it turned out, would not stay level; after trying to correct the "problem" by changing his delivery, he started throwing a so-called cut fastball that ferociously "cut" in on a batter's hands. Hitters knew it was coming but still missed. Many who made contact shattered their bats.

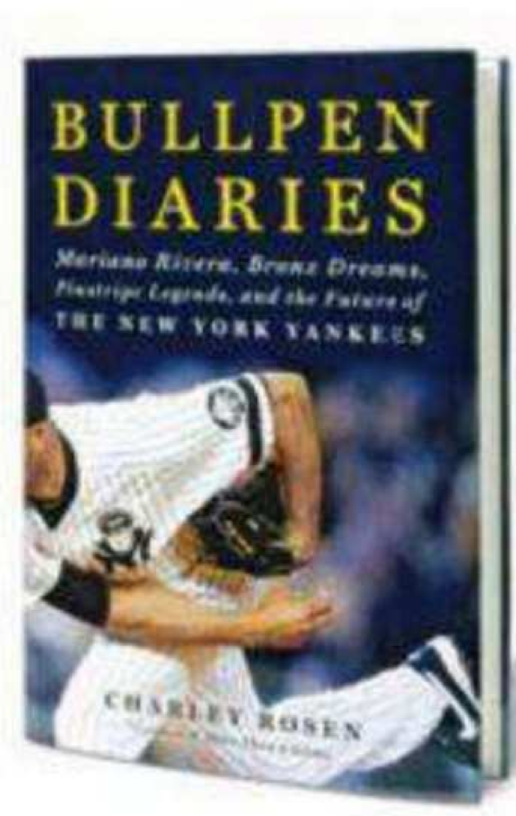
Watching Rivera remains one of the unspoiled pleasures left in big-time sports. He resembles an Egyptian deity, still and sphinx-like on the mound, his expression an enigmatic blank until, of a flash, he uncorks that cutter. Over the past 17 seasons the pitch has allowed him to rack up 570-plus saves and counting, fast closing in on Trevor Hoffman's record of 601. Rivera's virtuosity for collecting saves has earned him more than $130 million during the course of his career, not including his $15 million salary this season. It's an astonishing testimony to baseball's fetish for specialization. And therein lies a problem.

Rivera enters the game almost exclusively to record three outs in the ninth inning. And not just in any old ninth inning: He generally pitches only in a close game, to save a lead and nail down the win. Last year he pitched 60 innings and made more than $83,000 for each out he recorded. He racked up a quarter-million dollars per inning.

i

Bullpen Diaries: Mariano Rivera, Bronx Dreams, Pinstripe Legends, and the Future of the New York Yankees

By Charley Rosen
HARPER
384 pp; $25.99



Whether the Yankee ownership is getting its money's worth is not among life's great philosophical questions, but the optimal use of relief pitchers assuredly is. Today, bullpen aces are handled like hothouse flowers, but it was not always thus. As Rosen notes, Goose Gossage, the mustachioed fireman of the 1970s, '80s, and '90s, racked up 53 saves in which he retired at least seven batters. Rivera, on the other hand, has accomplished that feat just once. What's changed? Two things. First, the sport has developed a slavish devotion to saves—a textbook case of (mis)managing what you measure. The save statistic wasn't even created until 1969, and as economist Richard Thaler and legal scholar Cass Sunstein have written, "Most thoughtful observers realized long ago that this is a really dumb statistic."

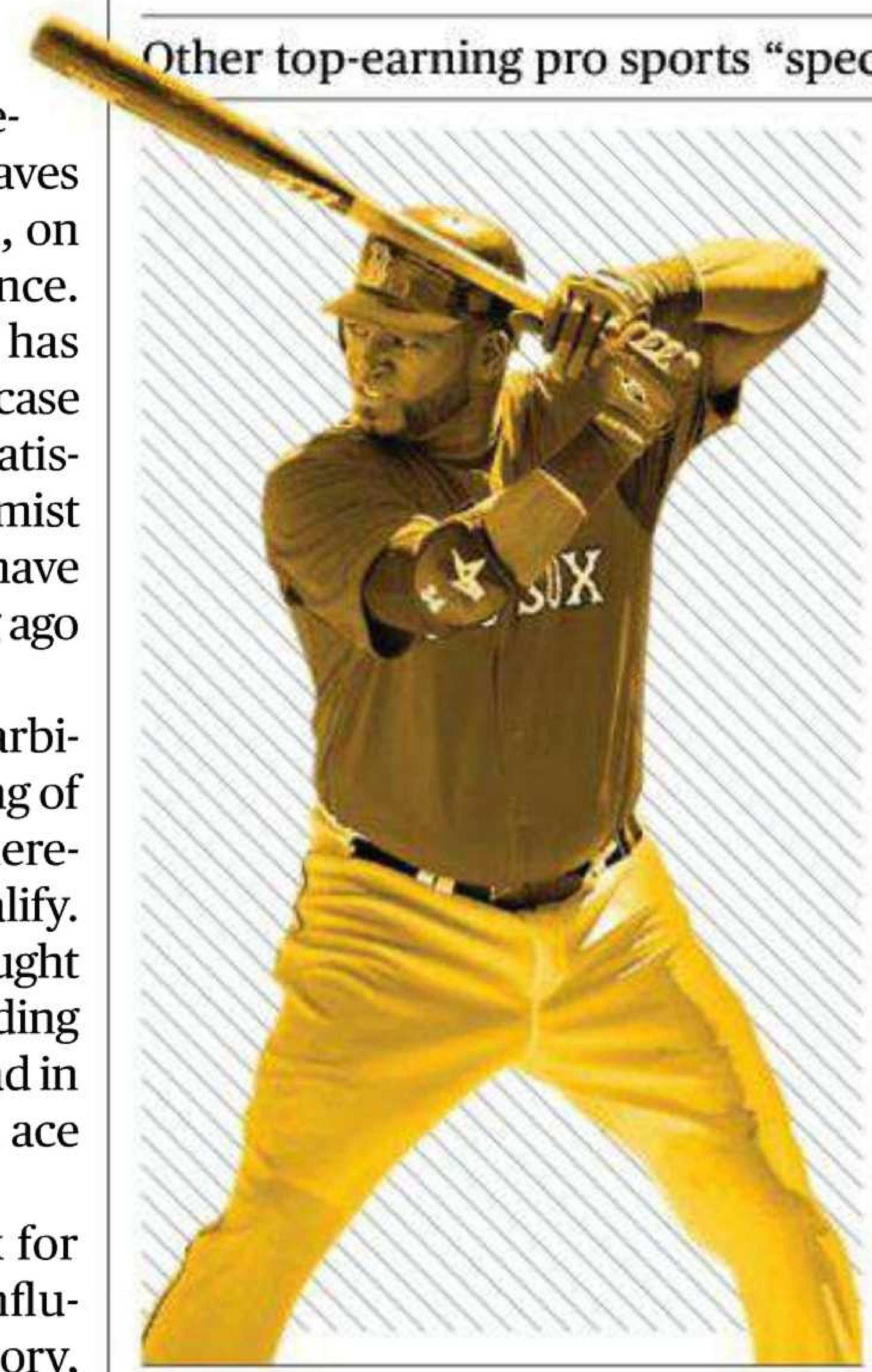
The problem is that the definition of a save is arbitrary. A pitcher entering the game at the beginning of the ninth when the score is tied is ineligible, whereas one who enters with a three-run lead will qualify. Such a stat does a poor job of measuring what it ought to—who contributes most to winning. And, according to Thaler and Sunstein, teams with a three-run lead in the ninth win 97 percent of the time anyway. An ace is not necessarily required for the job.

Second, besides giving agents a benchmark for negotiation, the measurement of saves has influenced managerial decisions for the worse. In theory, managers should use their best reliever whenever the game is on the line. Yet they do not. Thus, Rosen writes repeatedly (and uncritically) of how the Yankees' $15 million arm is reserved for a "save situation." To fully understand the illogic of designating the closer exclusively for ninth-inning work—and other so-called specialists for the seventh and eighth innings—one must remember that runs are equally valuable no matter the inning in which they are scored. This extreme specialization is motivated less by strategy than by managerial insecurity. A game lost in the eighth inning provokes the question of who was pitching and why the manager didn't yank him. A game lost in the fourth is simply a loss.

Rosen bows to the baseball cliché that only pitchers with icy veins can handle the ninth. And while Rivera might seem to prove the point, the pitcher's own take is more humble. Closing, he says, is simply a matter of being able to turn the page after a bad outing. Then again, starting pitchers have to do that, too. One is left to conclude that closers, as an asset, are systemically—and expensively—misused. But Yankees Manager Joe Girardi, like those other bosses in pinstripes, has also figured out that his $3 million per year job will be safer if he adheres to a conventional measuring stick—even if doesn't actually maximize his chances of winning. **B**

Nice Work If You Can Get It

Other top-earning pro sports "specialists." —*Ira Boudway*



$406,250
PER HOME RUN

David Ortiz
Designated hitter: Boston Red Sox

Last season's highest-paid DH played only four games in the field. His $13 million salary paid for 32 home runs.

$121,212
PER FIELD GOAL

Sebastian Janikowski
Kicker: Oakland Raiders

The Polish-born kicker has an average contract value of $4 million per year. That bought 33 field goals in 2010.





$32,407
PER FIGHT

George Parros
Enforcer: Anaheim Ducks

The Princeton grad is one of the league's top brawlers. He scored only three goals this season but had 27 major penalties for fighting.



$28,571
PER 3-POINTER

Matt Bonner
Three-point specialist: San Antonio Spurs

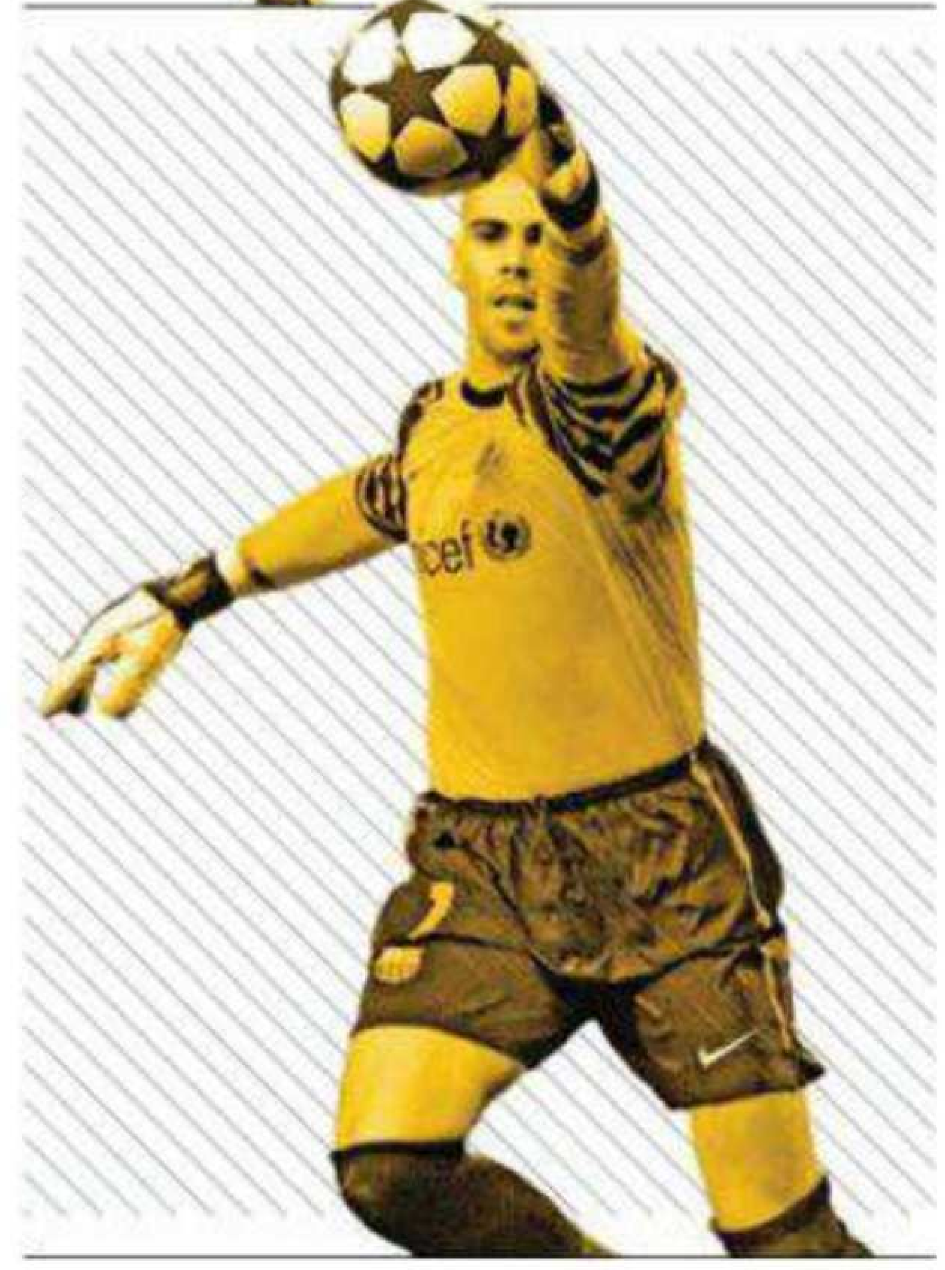
The sharpshooter started only one game last season, but his 46 percent accuracy from behind the arc led the league.



$1,141
PER GAME

Mika Koivuniemi
Bowler: PBA Tour

The 44-year-old Finn was the top earner on the Professional Bowlers Assn. tour this year, taking home $333,040 over 292 games bowled. Who knew bowlers lived so well?



$121,951
PER SAVE

Victor Valdés
Goalkeeper: Barcelona FC

The $10 million per year goalie plays behind the world's best offense, which controlled the ball for about 70 percent of the game last season.

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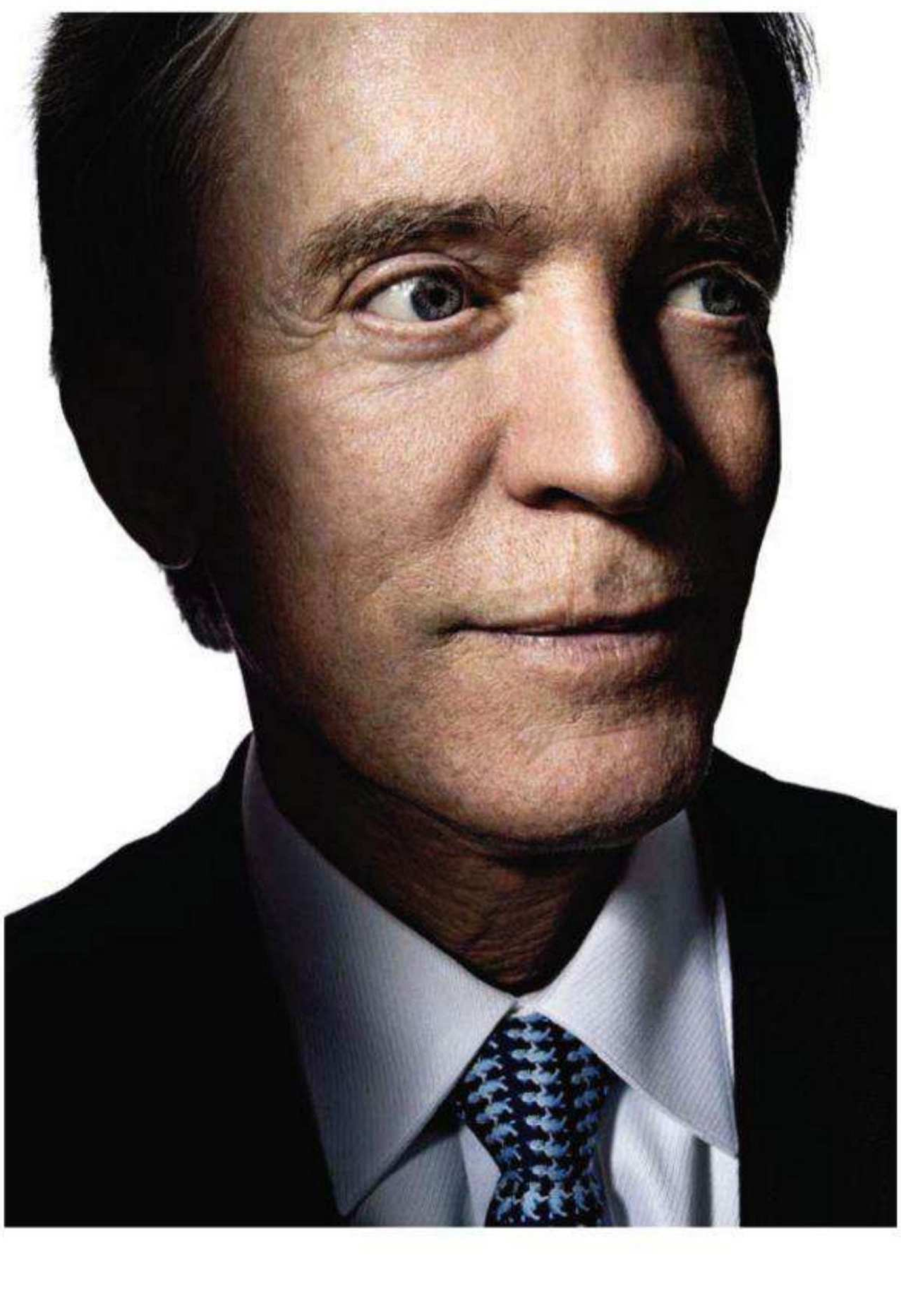
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Etc. Hard Choices

Bill Gross

"I wasn't necessarily proud of the obvious deception. But this little bit of trickery alerted us to what was really going on"

The co-founder of Pimco, the $1 trillion-plus fund manager, avoided the subprime bubble by turning his analysts into fake home buyers



In 2006, there were signs that this had become a highly leveraged Ponzi economy and that housing was at the pinnacle of this leverage. The temperature of the U.S. housing market was always best read here in Orange County [Calif]. But one day that August, as I was going across the street for my daily yoga exercise, it occurred to me that we needed to get a feel for the rest of the country.

We had 40 credit analysts covering companies like IBM and General Motors. I thought: Why not take 10 of these people and turn them into pretend real estate buyers? Instead of sending them to Armonk to interview the treasurer of IBM, let's send them to places like Detroit, Miami, or Vegas to pretend to be in the market to buy a house. They didn't have a bankroll, and they obviously weren't going to buy a house. Nonetheless, I gave each of them a territory and told them to go there two or three times a month until June 2008. They were told to be serious buyers, to get serious information.


There was no pushback, but I wondered whether it was kosher. I wasn't necessarily proud of the obvious deception. But this little bit of trickery alerted us to what was really going on: the liar loans and the extravagant lending practices. We got much better real-time information, and we learned homes were being bought without a down payment or without documents to prove income. The extent of the lending malpractice—to use a nice word—was shocking, and it caused us to stay out of the subprime market.

Timing is everything, though. It wasn't easy for quite a while: There was a stretch of nine to 12 months pre-Lehman where we were underperforming, and there was a lot of internal questioning and debate. Maybe we should jump in the pool with everyone else. Every investor has an alarm clock. I wish I could get up at 6 every morning and time things just right. I probably get up at 4:30. There's a cost to that hour and a half, where you sit around the table and acknowledge your competitors are having your lunch. But it's better than getting up too late. B

—As told to Diane Brady

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